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Efficient or Opportunistic: An Empirical Test of Managerial Discretion of Islamic Banking in Reporting the Earnings

Ahmad Abbas
STAIN Majene, Indonesia
email: ahmad.abbas@stainmajene.ac.id

Neks Triani
Universitas Sembilanbelas November Kolaka, Indonesia
email: nekstriani1987@gmail.com

Wa Ode Rayyani
Universitas Muhammadiyah Makassar, Indonesia
email: waode.rayyani@unismuh.ac.id

Maha Radwan
University of Turin, Italy
email: maha.radwan@unito.it

Abstract: Managers are responsible for the decision-making related to financial information. They make financial reporting incentives to manage financial data, including the earnings. Banks under Islamic principles seem to affect the probability of problematic managerial behavior in determining earnings. This study determines whether Islamic banking managers' discretion in reporting earnings is efficient or opportunistic. The sample of this study was Islamic commercial banks in Indonesia. The data was obtained from Bank Indonesia and Financial Services Authority. Their financial statements from 2010 to 2016 were analyzed using Moderated Regression Analysis. As reported by the analysis results, managers in Islamic banking are efficient in their discretion while reporting their earnings. Managers tend to level down their earnings when the profitability is exceptionally high at the current earning and movie it to the future earning making the profitability of Islamic banks seem stable.

Keywords: Discretion; Earnings; Efficient; Islamic Banking; Managers; Opportunistic

Abstrak: Manajer bertanggung jawab atas pengambilan keputusan yang terkait dengan informasi keuangan. Mereka membuat insentif pelaporan keuangan untuk mengelola data keuangan, termasuk pendapatan. Bank berdasarkan prinsip Islam tampaknya memengaruhi kemungkinan perilaku manajerial yang bermasalah dalam menentukan pendapatan. Studi ini menentukan apakah kebijaksanaan manajer perbankan Islam dalam melaporkan pendapatan efisien atau oportunistik. Sampel penelitian ini adalah bank umum Islam di Indonesia. Data diperoleh dari Bank Indonesia dan Otoritas Jasa Keuangan. Laporan keuangan mereka dari tahun 2010 hingga 2016 dianalisis menggunakan Analisis Regresi Termoderasi. Seperti yang dilaporkan oleh hasil analisis, manajer di perbankan Islam efisien dalam kebijaksanaan mereka saat melaporkan pendapatan mereka. Manajer cenderung menurunkan pendapatan mereka ketika profitabilitas sangat tinggi pada pendapatan saat ini dan memindahkannya ke pendapatan masa depan yang membuat profitabilitas bank Islam tampak stabil.

Kata Kunci: Diskresi; Pendapatan; Efisien; Perbankan Islam; Manajer; Oportunistik

Introduction

The bank endeavors to manage the firm value to remain stable for anticipating uncertainty in future financial status. This attempt can be carried out by earnings management practices. Managers in Islamic banking act adhering to Islamic principle with sharia corporate governance. Previous studies qualitatively demonstrate that Islamic banking tends to be opportunistic with unethical behavior (Hamdi & Zarai 2009; Hanif 2010; Jalal et al., 2016). Earnings are an essential parameter to measure firms' performance. Banks have a way of making their earnings look stable so that their business is reputed to be more profitable. Yet, is it permitted under Islamic principles? Income smoothing is one of the practices done by firms in earnings management. It could be ethical or unethical (Ibrahim, 2010). Hassan et al. (2014) perceive that managing earnings under Islamic principle is more emphasized as an unethical practice and jeopardizes future profitability. Other researchers have also noted this assumption (Hanif, 2010; Jalal et al., 2016), however, it is out of step with the Indonesian Ulema Council's paradigm (henceforth MUI). The *fatwa* of MUI regarding Income Smoothing published by National Sharia Board Number 87/DSN-MUI/XII/2012 indicates that earnings management is ethical. It can be practiced in the business area (DSN MUI, 2012). As a result, this *fatwa* is a leading financial institution in playing the discretion to report the earnings by managing the profit margin ratio.

Pertaining to the earnings management, the National Sharia Board of MUI states that there is the risk of customers' funds transfer or drawing from Sharia Financial Institution (Displaced Commercial Risk). The policy permits income smoothing through profit equalization reserve or no equalization. Therefore, in the perspective of the MUI, the *fatwa*'s fundamental source is based on Verse 29 Surah an-Nisa' that reads:

"O you who have believed, do not consume one another's wealth unjustly but only (in lawful) business by mutual consent.....

Another source as the benchmark for earnings management is the decision of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) in Mi'yar Syar'i (DSN MUI, 2012), referring to the firm budgeting or the shareholder decision. The firm may keep the profit without sharing it, allow a specific amount of profit to be shared regularly to improve performance or establish a reserve to mitigate the risk of capital losses or maintain profit margin stability. From the point of view of MUI's fatwa, earnings management is a policy addressed to provide the solvency reserve, investment risk reserve, and profit equalization reserve. It suggests that earnings management is usually done ethically.

In a theoretical concept, earnings management refers to managers' choice of specific objectives (Scott, 2015) to maximize stakeholder utility or interest. Income smoothing can be either harmful or good. It is assumed to be bad when managers conceal the information of earnings value to the principal. Providing more transparent and honest information, on the other hand, is beneficial, and discretion does not breach the rule.

Managers in Islamic banking act under Islamic principle with sharia corporate governance to display stable business performance. When the future period's earnings are expected to be lower, the previous period's earnings can be used to set the future period's earnings. The pattern of income decreasing will be employed if the firm value is forecasted to level up, and if the firm value goes down, the pattern of income increasing is employed (Abbas, 2018).

The profit earned by Islamic banks may fluctuate from one period to the next. As a result, banks may experience a loss for a period of time. In responding to this situation, managers are somehow given the discretion to overcome it. Hence, this study is designed to analyze it since sharia corporate governance is under Islamic principle making them fundamentally be tied by the sharia supervisory board. It may not, however, ensure that managers' discretion in reporting earnings is maintained. It can be a destructive practice when the manager serves as an opportunist in deceiving the information of earnings to the principal. Otherwise, it can be beneficial when the assumption aligns with the concept of Islamic principle serving as an efficient manager in reporting the earnings. Therefore, the behavior of Islamic managers in setting their earnings needs to be tested empirically and objectively to find managers' discretions, allowing Islamic banking executives to be assessed whether or not they act opportunistically. It remembers that Islamic principle affects the probability of managerial performance. The finding of this study is critical because some previous studies conclude that Islamic banking managers act opportunistically and serve the unethical behavior (Hamdi & Zarai 2009; Hanif 2010; Jalal et al., 2016). Their finding contradicts the *fatwa* of MUI regarding earnings management, indicating that it is ethical because managers perform under efficient principles to stakeholders. Consequently, this study tests the managers' discretion for aligning mixed findings. It is likely to be a tendency for managers to serve as an efficient or opportunistic agent in reporting the earnings, and this study will determine it.

An intentional structure of reports or decisions around economic impact encompasses income smoothing behavior. It alters reported income that would not occur unless management was concerned with the financial reporting implications (Ayres, 1994). Managers have the responsibility to make a decision related to financial information. They make an incentive to manage financial data, including the earnings. They use their judgments to conduct it. Shareholders, as the principal, need the information to see their performance and provide the incentive to managers. In this case, the interference of managers in setting reported earnings for external purposes should be known by the principle. It can alter the earnings and be harmful if managers do not coordinate with the principal to disclose the financial condition. One tactic is concealing the information related to the profit margin to maximize their interest by setting the recognition date or setting the earnings to increase the firm value through the maximization of the bonus scheme. This can be unethical or illegal business (Parfet, 2000). On the other hand, when managers perform for the genuine interest of stakeholders, they may create an excellent reputation and lower the risk.

In Islamic banks, sharia corporate governance has sharia supervisory board (Budisantoso & Nuritomo 2014) mainly. Wijayanti and Diyanti (2017) assert the effect of sharia corporate governance on corporate governance in Islamic banks. It induces managers to report their earnings in line with the expectation of shareholders and to overcome the financial uncertainty leading to the decline of future banking profitability. Thus, the current profitability can be set using income decreasing.

Furthermore, the discretion of Islamic banking managers in making a policy to determine their earnings seems interesting to be more explored after the release of the *fatwa* of MUI. Efficient or opportunistic is a tendency of managers' action to play their discretion in the financial report. It is managed as the form of behavior within encountering the profitability uncertainty. Moral hazard is a concern for opportunistic managers. In the frame of agency theory, the relation of agency leads to the asymmetric information in which managers have access to play the report. In another perspective, managers can behave efficiently to protect the business and anticipate performance uncertainty. There is no asymmetric information in an efficient perspective. In this study, managers act efficiently if sharia corporate governance interacts strongly to support the discretionary of managers. On the other hand, they become opportunistic if it interacts weakly to repel managers' discretionary.

The preliminary finding of this study reflects the tendency of sharia commercial banks in Indonesia on discretionary accruals, earnings, and sharia corporate governance. Further, findings of this study can clarify prior studies, provide the conclusion from previous researches, and justify the decision that Islamic banking managers adhere to *fatwa* of MUI in the concept of efficiency.

Thi study contributes to signal the stakeholders that managers in Islamic banking fundamentally have incentives to manage their reported earnings.

Literature review

To gain market share, Islamic banks should develop new products and services (Muhammad & Lanaula, 2019). The manager is expected to gain more profit or make financial performance stable each period. Financial statements describe the firm performance information. This relates to earnings management. Earnings management refers to the choice of managers to specific objectives (Scott, 2015). Managers tend to choose the accounting policy, for instance, revenue measurement through depreciation policy and recognition timing, discretionary accrual through loan loss provision. It aims to maximize the utility of stakeholders' interests. Watts and Zimmerman (1990) implied determinants of managers to commit the earnings management. First, it is the bonus plan hypothesis. This is an opportunistic motive to encourage the firms to provide a high bonus based on the income. Second, it is the debt covenant hypothesis pertaining to the breach of the credit agreement. Last, earning management refers to the political cost hypothesis, such as the tax payment.

Under the tenet of agency theory, the firm is an intersection point in a managerial relationship between the principal and the agent. Managers serve as the agent and are involved in managing financial data to make decisions. They tend to hold an opportunistic perspective to manage earnings when motivated to perform to profit. In this case, they attempt to mislead the principal through financial judgment. The agency theory is always related to the theory of corporate governance in the development of researches to understand managerial characteristics on the firm value (Carter, Simkins, & Simpson 2003). The research area in corporate governance is frequently related to agency problems. The separation of interests between principal and agent leads the conflict. The agent is inclined to feel that he has performed well, and incentives provided by the principal are not suitable for the utility. He encourages himself to gain more profit through discretion. The principal obtains less information about the firm's financial condition so that the agent can opportunistically provide misleading information. The skill and capacity of the agent are required to build and develop the business mandated by the principal. Therefore, the quality of firms' performance tends to be managed by the agent.

Earnings management is declining the reliability of financial information leading to a change in return and portfolio risks (Ashari et al., 1994). It has been a controversial area from an ethical perspective. Some of the latest earnings management proponents find that the tenet of earnings management is opportunistic behavior. Elleuch and Taktak (2015) found that banking managers have practiced earnings management after publishing the first International Monetary Fund (IMF) report in Tunisia. At the same point of view, Wu, Gao, and Li (2016) disclosed that managers tend to use their discretionary to reduce or relieve the pressure they feel from the media and repair firm reputation.

Inefficient managerial behavior and managing earnings can be good if used responsibly. It is not problematic when no rules are broken (Jooste, 2011). However, it can be problematic when managers make asymmetric information encouraging them to profit. Still, it can also be ethical when managers' discretionary decisions align with the principal's interest, although it provides pressure. Septiari and Maruli (2017) found the effect of pressure on performance behavior. The pressure comes in legal consequences and justifies a decision to maximize the performance outcome.

From the perspective of efficiency, this study examines the altruistic behavior of managers behavior in managing Islamic banking income. There is no information asymmetry between manager and principal. Because the manager is not an agent but a steward. The role of stewardship derives from the separation between ownership and management in the company. Thus, in the theory of stewardship, the manager is positioned as a steward against shareholders (Ronen & Yaari, 2008).

DeAngelo (1986) revealed that accounting numbers play a central role in mitigating conflicts of interest between managers and stockholders. Banks may seek to put in a mechanism to align the willingness of agents and principals through corporate governance. Based on the latest literature, Li, Zhao, and Zhao (2019) found that corporate governance can scrutinize managers' behavior. Firms with weak corporate governance encourage managers to set the earnings. Managers behave efficiently if corporate governance interacts strongly to support the discretionary of managers. Thus, earnings management is the discretion to increase the firm value. Banks have the incentive to lower earnings volatility through income smoothing (Abbas, 2018). They use loan loss provisions related to future earnings change (Ahmed et al., 1999). When the income increase is high, managers smooth it to maintain firm value stability. Therefore, managers behave efficiently when the pattern of earnings is managed in a specific condition to protect the firm's growth.

Methods

The final sample of this study was seven sharia commercial banks listed in Financial Services Authority and Bank Indonesia. Examining data of the latest years, data from 2011 to 2016 were investigated. This study identified the discretion of managers proxied by discretionary accruals through the equation model of Beaver and Engel (Beaver & Engel 1996). Earnings are proxied using future profitability and sharia corporate governance is proxied using the sharia corporate governance disclosure index.

The earnings managed for the financial reporting are managers' discretion detected through the accruals. This study employed the model of

Beaver and Engel (1996), emphasizing loan loss provision[1]. It is a function of the accounting system providing the estimate and assumptions made by bank managers (Ozili & Outa, 2017) and can also be functioned in Islamic banks as employed by Salem et al. (2021). The formula of the equation is presented as follows:

$$TA_{it} = DA_{it} + NDA_{it}$$

$$DA_{it} = TA_{it} - NDA_{it}$$

TA is total accrual, DA is discretionary accruals, and NDA is a non-discretionary account. TA is measured using a loss provision on productive assets. The equation is formulated as follows.

$$TA_{it} = \alpha + \beta_1 CO_{it} + \beta_2 LOAN_{it} + \beta_3 NPA_{it} + \beta_4 \Delta NPA_{it+1} + \varepsilon$$

All variables in the equation are already deflated by GBV, where GBV comes from equity and total allowance for loan losses. The coefficient from the result of the equation of TA was used to obtain NDA with the following equation.

$$NDA_{it} = \alpha + \beta_1 CO_{it} + \beta_2 LOAN_{it} + \beta_3 NPA_{it} + \beta_4 \Delta NPA_{it+1}$$

This model has been effective for years and is relevant to detect discretionary accrual in the banking industry. Provision for losses on productive assets is the measurement of total accrual in the banking industry. It can be estimating the market evaluation on discretionary and nondiscretionary accruals.

Where CO is charge-offs loans, LOAN is outstanding loaned, NPA is a nonperforming asset, ΔNPA is a change of nonperforming assets, the difference between nonperforming assets between t+1 and t.

Furthermore, earnings were proxied using future profitability measured from earnings before tax for one future period (EARN $_{it+1}$) divided by total assets for the current period (Total Asset$_t$). For sharia corporate governance, the disclosure index utilized a design for the Islamic banking industry by Darmadi (2013). This study reconstructed it to adjust the design of this study. First, it was measured from the score of total indices disclosure by Islamic banks divided by whole total disclosures.

The test of managers' discretion used Moderated Regression Analysis (MRA). Discretionary accruals were utilized as the independent variable. The dependent variable was earnings. Sharia corporate governance served as a moderating variable.

The beginning step to analyze the research model is by testing the relationship between discretionary accruals and earnings to provide the causal effect. At the final step, sharia corporate governance interacts with both variables' relation. If the result shows the same effect, it signs efficient behavior, and if the effect is the opposite, it indicates opportunistic behavior.

Result and discussion

The result of descriptive statistics is presented in Table 1. For a sample of 49 observations, the lowest and highest values of the discretionary accruals (DA) are -0.516 and 1.329, with the mean of 0.318 having a positive score. It indicates that managers' discretion in managing the earnings uses income increasing. For future profitability (EARN), the value is -0.113 for the lowest level, and 0.064 for the highest level, with the mean, is 0.001 showing a positive value. It implies that Islamic banks have a low rate of profit.

Table 1. Descriptive Statistics

Variable	Min	Max	Mean	Std Dev
Discretionary Accruals (DA)	-0.526	1.329	0.318	0.424
Future Profitability (EARN)	-0.113	0.064	0.001	0.024
Sharia Corporate governance (SCG)	0.838	1.000	0.930	0.042

Furthermore, the lowest value of sharia corporate governance (SCG) is 0.838. On the other hand, the highest value is 1.000, with the mean value of 0.930 indicating that the mean of corporate governance of Islamic banks has a high index. In other words, the mean value of Islamic banks in Indonesia has good corporate governance under the sharia principle. Therefore, the descriptive statistics result briefly explains that the mean of Islamic banking managers in Indonesia has operated earnings maximization with a low value for future profitability and high index for corporate governance.

Table 2 presents the value of discretionary accruals generated by sharia banks. It shows the patterns that have suffered fluctuating earnings. Based on the mean of discretionary accruals, Panin Syariah had the highest value of 0.465, showing that it tends to use income increasing as the pattern of managing the earnings. In 2016, it followed the pattern of the highest value in the income increase. It discloses that Panin Syariah attempts to remedy the performance to be stable in seven periods. The lowest value of earnings management has been experienced by Syariah Mandiri with the value of 0.174 and followed by Muamalat Indonesia with the value of 0.175. These disclose that managers of both banks have played discretionary patterns through income decreasing and increasing so that their performance looks stable over some years.

Table 2. Discretionary Accruals

Bank	2016	2015	2014	2013	2012	2011	2010	Mean
Muamalat Indonesia	-0.10	0.17	0.09	-0.52	0.14	1.33	0.11	0.18
BNI Syariah	0.37	0.78	0.13	1.04	0.28	0.67	-0.02	0.47
BRI Syariah	0.14	0.40	-0.01	0.11	0.07	1.05	0.33	0.30
Mandiri Syariah	0.53	0.12	-0.13	-0.19	0.33	0.25	0.31	0.17
Bukopin Syariah	0.90	0.31	0.85	0.02	-0.41	0.09	0.98	0.39
BCA Syariah	-0.17	0.99	0.65	-0.07	0.16	0.01	0.14	0.25
Panin Syariah	1.10	0.21	-0.09	1.09	0.19	0.35	0.51	0.48
Discretionary Accruals emphasizes on loan loss provision measured using DA_{it}= TA_{it}-NDA_{it}								0.32

The future profitability of sharia banks presented in Table 3 showing that all banks have fluctuated profitability. Five banks consisting of Muamalat Indonesia, BNI Syariah, BRI Syariah, Mandiri Syariah, and BCA Syariah had the mean with a positive value of future profitability, disclosing that from 2010 to 2016, these banks gained more profit. In contrast, the remaining two banks, of Bukopin and Panin Syariah suffered the loss. Even in 2016, both were in negative profitability.

In addition to the descriptive statistics of future profitability, during the periods of 2010-2016, Muamalat Indonesia had the mean with the highest value of 0.012. It discloses that Muamalat Indonesia gains more earning performance than the other banks.

Table 3. Future Profitability

Bank	2016	2015	2014	2013	2012	2011	2010	Mean
Muamalat Indonesia	0.035	0.002	-0.006	0.012	0.064	-0.079	0.057	0.012
BNI Syariah	0.001	0.002	0.003	0.003	0.002	0.000	0.000	0.002
BRI Syariah	-0.002	0.002	0.006	-0.007	0.002	0.008	0.000	0.001
Mandiri Syariah	0.001	0.001	0.005	-0.001	-0.015	0.005	0.004	0.000
Bukopin Syariah	-0.012	-0.004	0.004	-0.001	-0.001	0.002	0.001	-0.002
BCA Syariah	0.002	0.003	0.004	-0.004	0.000	0.001	0.001	0.001
Panin Syariah	-0.113	-0.005	-0.003	0.017	-0.017	0.028	0.003	-0.013
Earnings is proxied using future profitability measured from earnings before tax for one future periode ($EARN_{it+1}$) divided by total asset for current period ($Total\ Asset_t$)								0.001

Table 4. Sharia Corporate Governance

Bank	2016	2015	2014	2013	2012	2011	2010	Mean
Muamalat Indonesia	1.000	0.926	0.941	0.985	0,926	0.926	0.926	0.963
BNI Syariah	0.985	0.985	0.912	0.926	0,926	0.838	0.838	0.914
BRI Syariah	0.985	0.985	0.912	0.912	0,838	0.838	0.838	0.912
Mandiri Syariah	1.000	0.926	0.926	0.926	0,941	0.941	0.941	0.943
Bukopin Syariah	0.985	0.985	0.941	0.941	0,941	0.941	0.941	0.956
BCA Syariah	0.926	0.926	0.926	0.926	0,926	0.926	0.926	0.926
Panin Syariah	0.926	0.838	0.926	0.897	0,897	0.897	0.897	0.897
Sharia Corporate Governance is proxied using the Corporate Governance Disclosure Index (CGDI) measured from the score of total indices disclosure by Islamic banks divided by total whole disclosures								0.930

Table 4 outlines the descriptive statistics result of sharia corporate governance in sharia banks in Indonesia. Some dimensions to construct the corporate governance in this study are the sharia supervisory board, board of commissioners, board of directors, board committees, internal control and external audit, risk management, and the report of corporate governance implementation. Based on the mean of value sharia corporate governance, Muamalat Indonesia has the best sharia corporate governance with the highest index of 0.963. Muamalat Indonesia has implemented all dimensions. For the Panin Syariah, it had the lowest corporate governance. This may occur because Panin is the newest Islamic bank in Indonesia operating since 2009.

Efficient or Opportunistic: The Effect Test

The regression model has favoured the random effects estimator and data meeting the classical assumptions. Afterwards, the effect of discretionary accruals on future earnings was tested. As shown in Table 5, the result obtains the negative coefficient of -0.022 with a significance at the level of 0.01. It is found that the relationship between discretionary accruals and future earnings is negative. It indicates that future profitability declines when managers have discretion in reporting the earnings. In other words, when profitability is low, managers attempt to maximize it by taking the earnings kept at the previous period. As a result, Islamic banks whose low earnings in the future period induce managers to do income increasing in the future period.

In determining whether managers are efficient or opportunistic, the test of interaction effect was run using Moderated Regression Analysis (MRA). As a result, Sharia corporate governance interacted with discretionary accrual and future profitability. The result of the interaction test is presented in Table 6.

Table 5. The Effect Test

	Coefficient	**t-statistic**
Intercept	0.007	1.719*
Discretionary Accruals (DA)	-0.022	-2.788***

N = 49
R^2 = 0.142
Adj. R^2 = 0.124
F-Statistic = 7.775***
Dependent Variable: Future Profitability (EARN)
***significant at the 0.01 level; **significance at the 0.05 level; *significance at the 0.1 level

Tabel 6. The Test of Interaction Effect

	Coefficient	**t-statistic**
Intercept	0.007	1.740*
DA*SCG	-0.024	-2.883***

N = 49
R^2 = 0.146
Adj. R^2 = 0.128
F-Statistic = 8.026***
Dependent Variable: Future Profitability (EARN)
***significant at the 0.01 level; **significance at the 0.05 level; *significance at the 0.1 level

The interaction effect between variables in Table 6 shows a negative coefficient of -0.024 at the significant level of 0.01. The result provides a negative direction. It follows the direction of the same effect of discretionary accruals on future earnings, as shown in Table 5. To conclude, managerial discretion is supported by the management and stakeholders. Hence, the study discloses that Islamic banking managerial discretion efficiently reports earnings.

Sensitivity Analysis

This study does not only perceive earnings as a form of profitability in the banking industry. Cash flow can also be the parameter of the level of firm welfare. This study did the additional test by substituting the proxy of Future Earnings to be Future Cash Flow to analyze the variable sensitivity. Thus, the finding of this study can provide consistent and reliable inferences.

As shown in Table 7, cash flow is measured using cash flow operation before tax for one future period (CFO_{it+1}) divided by total assets for the current period ($Total\ Asset_t$). The result shows a negative coefficient of -0.297, significant at the 0.01 level. It is found that the relationship between discretionary accruals and the future cash flow is negative. This test provides the same result when using the earnings (EARNS) variable.

Table 7. Additional Effect Test

	Coefficient	t-statistic
Intercept	0.140	3.170***
Discretionary Accruals (DA)	-0.297	-3.546***

N = 49
R^2 = 0.211
Adj. R^2 = 0.194
F-Statistic = 12.572***
Dependent Variable: Future Profitability (CFO)
***significant at the 0.01 level; **significance at the 0.05 level; *significance at the 0.1 level

Table 8. Additional Test of Interaction Effect

	Coefficient	t-statistic
Intercept	0.139	0.003***
DA*SCG	-0.319	-3.541***

N = 49
R^2 = 0.211
Adj. R^2 = 0.194
F-Statistic = 12.538***
Dependent Variable: Future Profitability (CFO)
***significant at the 0.01 level; **significance at the 0.05 level; *significance at the 0.1 level

The further test analyses the effect of interaction. The result of the test is presented in Table 8. It shows that the interaction effect has a negative coefficient of -0.319 at the 0.01 level. The result of this test provides a negative direction. It has the same direction when using the earnings (EARN) variable, as shown in Table 6. Therefore, a testing model designed in this study is consistent and accountable.

After the sensitivity analysis, the finding of this study consistently provides a negative effect of the relationship between discretionary accruals and earnings. The effect of sharia corporate governance on the connection between the two variables is negative. When the effect test in this study yields the same result, it demonstrates efficient behavior. In other words, this finding reveals that managerial discretion is efficient. The earnings management negatively affects future profitability and sharia corporate governance can strengthen its effect. It demonstrates that when Islamic banking earnings are incredibly high at the current period, managers play their discretion to set it by minimizing the volatility so that the earnings become smooth and seem stable.

This finding is in line with the *fatwa* of MUI Number 87/DSN-MUI/XII/2012 (DSN MUI, 2012) and previous studies (Hamdi & Zarai 2009; Hanif, 2010; Jalal et al., 2016). It is viewed as ethical because managers behave efficiently in reporting the earnings. Efficiency is implemented to protect the profit equalization reserve. Furthermore, regulatory motivation also becomes the primary incentive in earnings management. It is significant for encouraging banks to operate well and thereby avoid customers to convert their funds to conventional banks. In corporate governance, banks have a larger and better portfolio than non-banks. Banking corporate governance refers to regulated and controlled organizations. The decision can be made effectively when the corporate governance has been good. It provides the impact leading the performance to grow and the risk resource to become efficient. In Islamic banks, the sharia supervisory board becomes additional governance. The mechanism of sharia corporate governance is addressed to align with the shareholder's interest. The mechanism aims to increase the utility of shareholders and the manager attempts to avoid the conflict of interest. The sharia supervisory boards aid the monitoring effectively (Almutairi & Quttainah 2020). They oversee the implementation of Islamic business ethics (Mukhibad & Nurkhin 2019).

Based on the finding of this study, earnings management in the perspective of efficiency is perceived positively and provides a way to give information of firms related to stability expectations. Accounting methods made by the managers may be selecting the most efficient way to portray the firm's performance to keep a good image. As a result, the result indicates that when managerial discretion is efficient, the value of future profitability declines, resulting in a decrease in future earnings and cash flow. The declining value occurs because the past period has been managed through income decreasing. To avoid fluctuating profitability, managers reinforced by sharia corporate governance are constantly monitoring the current period's high volatility.

Conclusion

The sharia corporate governance interacts with the accrual discretionary in affecting the earnings. The variable has a positive response to managerial discretion in managing earnings. The governance of Islamic banking can strengthen the decision of Islamic managers in reporting the earnings. It reveals that the manager behaves efficiently in earnings management. Islamic banking managers work to achieve the business goal of increasing the wealth of investors' equity by increasing the firm value. Earnings quality tends to be very high over several periods. Managers should consider and estimate the banking value when eliminating past earnings items to improve future period items. This study successfully designs and provides the inference in line with the *fatwa* MUI and the concept of an efficient paradigm in earnings management. The role of managers is needed to regulate profits for banking performance to remain stable. This shows that managers play discretionary accruals that need to be strengthened by sharia corporate governance. This study notes that Islamic banking managerial discretion behaves efficiently in reporting their earnings.

Earnings management through discretionary accrual is one of the ways to convey company information related to profit expectations. It points to maximize the utility of stakeholders' interests. This research suggests that Islamic banking managements benefit from ethical behavior. They do not breach the rule since they adhere to the Islamic principle under the *fatwa* of MUI. Although it is in line with legal consequences and written justifications in the form of a *fatwa*, the result of this study should also alert the policymakers to frequently watch the practice in the banking business. It is worth noting that this study only involved seven banks with the financial statements from 2010 to 2016. This study is aware that the number of Islamic banks in Indonesia is not equal to commercial banks. Nevertheless, we have attempted to build the research model and validate the data accurately. In addition, this study was limited to conduct additional analysis to the dependent variable, but not the independent variable of the managerial discretionary. Therefore, the measurement of discretionary accruals in the further study can utilize abnormal production costs or abnormal discretionary expense.

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