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Towards a *Maqashid Sharia*-based Conceptual Framework of Islamic Financial Reporting in Indonesia: Criticizing "Economic" Decision Usefulness Objective

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Abstract

All the Conceptual Framework of Financial Reporting put economic decision-making usefulness the objective of financial reporting, including what so called as the Basic Framework for the Preparation and Presentation of Sharia Financial Statements (BFSFS) in Indonesia. BFSFS is the Indonesian conceptual framework adopted by the Indonesian Institute of Accountants (IAI) from the Framework for Preparation and Presentation Financial Statement International Accounting Standards Committee (IASC). Many criticisms are addressed to BFSFS because it is seen as carrying the interests of capitalism, imperialism and secularism. This article aims, first, to criticize the concept of "sharia principles" used as the foundation for the development of BFSFS in Indonesia; second, to criticize the use of decision usefulness concept as the main objective of sharia entity financial report adopted by BFSFS; third, to initiate maqashid sharia as the foundation of sharia Conceptual Framework of Financial Reporting development. In doing so we use criticism-reflective-constructivist approach.

Key words: *Maqashid Sharia, maslahah*, objective of financial reporting, sharia accounting conceptual framework

1. INTRODUCTION: EVOLUTION OF THE INDONESIA'S ISLAMIC ACCOUNTING CONCEPTUAL FRAMEWORK

The population of Indonesia is 237.6 million and 87.1 percent of them are Muslim (BPS, 2010). Despite occupying the fourth rank of the world population after China, India and the US and has the largest Muslim population in the world, the Islamic financial system in Indonesia just began in 1992 marked by the operation of the first Islamic (sharia) Bank, Bank Muamalat Indonesia (BMI); and is followed by the establishment of the first sharia insurance company, PT Syarikat Takaful (ST) in 1994 (Warde, 2000). After nearly three decades of the operation of those two institutions, the total assets of Indonesia's sharia finance (excluding Sharia Stock) reached IDR1,048.8 trillion[1] (8.01%) of the total assets of the national financial industry, which reached IDR13,092 trillion. In more detailed, sharia banks contribute IDR389.74 trillion (5.44%), sharia IKNB[2] contributes IDR99.15 trillion (4.78%), and sharia capital market contributes IDR559.59 trillion (14.49%) (OJK, 2017).

[1] USD1 equals to IDR13.380 as of 13 April 2018
[2] IKNB= Industry Keuangan Non-Bank (Non-bank financial industry)

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The operation of BMI and ST, however, does not directly affect the development of sharia accounting standards. For the internal needs of BMI, BMI translated AAOIFI (Accounting and Auditing Standards of Islamic Banks and Financial Institutions) in September 1998 as the financial reporting guide. Meanwhile, the issuance of Accounting Standards for Sharia Bank (PSAK 59) in 2002 was closely linked to the operation of PT Bank Syariah Mandiri (BSM) in 1999 (Siswantoro and Muttalib, 2004).

Bank of Indonesia (BI) together with the Indonesian Institute of Accountants (IAI) are two important players in the emergence of PSAK 59 and Basic Framework for the Preparation and Presentation of ***Sharia Bank*** Financial Statements (hereafter BFSBFS) in 2002. PSAK 59 and BFSBFS is then followed by the issuance of Accounting Guidelines for Indonesian Sharia Bank (AGISB) in 2003 which strongly supports sharia accounting practices in sharia bank. Finally, the development of various sharia entities pushed the Financial Accounting Standards Board (DSAK) of the IAI to revise BFSBFS into a Basic Framework for the Preparation and Presentation of ***Sharia*** Financial Statements (BFSFS) in 2007.

BFSFS is the result of "Islamization or Shariahization" of Basic Framework for the Preparation and Presentation of Financial Statements (BFFS), done by the Sharia Accounting Committee of IAI in filtering various concepts in BFFS: accept if in accordance with sharia, reject (or adjust if possible) if not in accordance with sharia (Birton et al., 2015). BFFS is adopted from Framework for Preparation and Presentation of Financial Statement (FPPFS) of the International Accounting Standard Committee (IASC). The adoption was in 1994. However, since January 2017, IAI officially adopted the Conceptual Framework for Financial Reporting (CFFR) of the International Accounting Standard Board (IASB). The adoption of CFFR by IAI automatically revokes BPPFS. The adoption of CFFR by IAI has serious implications for BFSFS because this BFSFS has lost its historical basis, contextuality, and connectivity as BFFS's complement. Consequently, it needs revision. However, where should BFSFS revisions be directed?

There are two options that the Sharia Accounting Standards Board (DSAS)[3] may choose. First, perform the "shariahization" of CFFR, as has been done on BFFS, and treat it as the complement to CFFR. However, this choice has negative consequences as the substance of CFFR of the IASB is the expression and accommodation of the various faces of capitalism (Walker, 2010) and contains imperialistic characteristic (Gallhofer et al., 2011). Consequently, if this option is taken, it may bring reputational risks to the DSAS as DSAS will be seen as pragmatic in legitimizing the interests of capitalism and global imperialism. Second, develop a new framework, which is more independent and contextual, without forgetting its connectivity with the CFFR, but with a more progressive and comprehensive Islamic perspective. The Islamic progressiveness here means no longer taking "sharia contracts" as the only factor to measure the sharia legitimation. Because, as Rosly (2010) points out, "sharia contract" is no longer adequate as the only indicator in judging the sharia legitimation of an Islamic financial instrument. Hence, placing sharia transactions as the paradigm in developing the conceptual framework of sharia financial reporting may cause the Conceptual Framework for Sharia Financial Reporting (CFSFR) to be problematic, limited, and will always be a complement to the "conventional" conceptual framework. Therefore, other aspects need to be considered, such as *Maqasid Sharia* (the Objectives of Sharia, hereafter MS).

In fact, the MS has been incorporated into BFSFS implicitly by principle of goodness (*maslahah*), in addition to other four principles: brotherhood (*ukhuwah*), justice (*'adalah*), balance (*tawazun*), and universalism (*syumuliyah*) (BFSFS par. 15). However, since it is only as one of the principles, the concept of MS cannot be elaborated extensively to be more coherent and comprehensive basis for the development of BFSFS.

Indeed, there are a number of advantages if MS is used as the paradigm of in developing BFSFS. First, while "sharia transaction" appears to be superior in terms of practicality and procedures, it is dry from the philosophical and spiritual-ethics perspectives. Second, MS is more flexible methodologically. MS is able to bridge the needs of the various parties because of its flexibility in the use of revelation, reason, senses, and intuition as an epistemological foothold. As a conceptual framework should be practical but also philosophical and ethical, the use of MS is much more flexible in addressing those needs. Sharia transactions later may become a subset of MS. Third, from the coverage perspective, MS seems superior to solve various problems, as MS is able to connect various needs of human beings (individual,

[3] DSAS is the new organ of IAI replacing the Sharia Accounting Committee of IAI and independent from DSAK.

organizational, communal, and environmental needs at the same time). So far, MS has been able to be the foundation in the study and development of various disciplines, including business and economy, such as sukuk (Naim, et.al. 2013); sharia financial instruments (Rosly, 2010); Islamic finance and banking (Azli et al., 2011; Ahmed, 2011; Dusuki and Bouheraoua, 2011; Shaharuddin, 2010); zakah (Abd. Rahman and Ahmad, 2010); corporate social responsibility (Dusuki and Abdullah, 2007); and sharia accounting (Abd Rahman, 2010; and Birton, 2015).

This paper aims, first, to criticize the term "sharia principles" commonly used in regulating entities and sharia instruments, and academic studies, including the preparation of BFSFS in Indonesia. Although this term is already commonly used for various legal products, such as laws and various other regulations under it, but it is meant differently. Second, to criticize the use of economic decision usefulness concept adopted by BFSFS, as the main objective of sharia entity financial statements and to initiate MS as the foundation of CFSFR development.

2. SHARIA PRINCIPLES: UNFINISHED DEFINITIONS

The establishment of BMI is likely does not have a strong regulatory foundation. Its presence is more about exploiting accommodative political changes and some legal loopholes arising from a series of banking deregulation (liberalization), beginning with the June Package in 1983 (Sukarman, 2014) and the December Package in the same year allowing banks to charge 0% (zero interest) loans (Anshori, 2008). Thus, when BMI obtained an operating license in 1991, it used the legal loophole of 0% interest.

Law Number 7 of 1992 on Banking which was passed on March 25, 1992 did not contain the dictum that regulates sharia bank. The real regulation of sharia bank exists after the issuance of Government Regulation Number 72 of 1992 about Banks with Profit Sharing Principle issued on 30 October 1992, or approximately 6 months after BMI was in operation. Then, after the issuance of Law Number 10 of 1998, to replace Law Number 7 of 1992 on Banking, the terms of sharia banks have explicitly emerged. The full regulation on sharia banks, however, exists in 2008 after the issuance of the Sharia Banking Law Number 21 of 2008.

The terms of "Sharia Principles" first appeared in Law Number 10 of 1998 on Banking, to replace Law Number 7 of 1992. This is set forth in article 1 (13):

> *"(Sharia Principle is a rule of contract based on Islamic law between banks and other parties for the deposit of funds and/or financing of business activities, or other activities stated in accordance with sharia, such as financing based on profit sharing principles (mudharabah), financing based on the principle of equity participation (musharakah), the principle of buying and selling of goods by obtaining profit (murabaha), or financing of capital based on the principle of pure lease without option (ijarah), or by the option of transferring ownership of leased goods from the bank by another party (ijarah wa iqtina)."*

Law of the Republic of Indonesia Number 21 of 2008 on Sharia Banking Article 1 (12) states:

> *"Sharia Principles is the principles of Islamic law in banking activities based on fatwas issued by institutions that have authority in the establishment of fatwa in the field of sharia."*

From the above quotation, the sharia principle is interpreted narrowly, (1) as a rule of agreement (*akad*) or contract that uses Islamic law, such as *mudharaba*, *musharakah*, and others; or a more general meaning, namely (2) Islamic law. The emergence of difference meanings is because sharia contract and sharia principles ontologically are two different entities. Just since the enactment of Law Number 21 of 2008 on Sharia Bank, the meaning of sharia principles in the sharia banking industry becomes more consistent.

Law Number 19 of 2008 on State Sharia Securities, although published almost simultaneously with Law Number21 of 2008, the former does not mention the principles of sharia in the body, including in the definition. The terms of sharia principles appear extensively in the explanatory section of the Act. However, the selected phrase is not “sharia principles” but “Islamic sharia.”

“Islamic sharia” means the sources of sharia (Al-Quran, Hadith, and Ijma'), while the terms of “sharia principles” refers to more general and comprehensive meanings because it combines legal principles (*halal*) and ethics (*fair, thayyib,* and *maslahah*), and does not emphasize the sharia (transaction) contract. The relevant sections to compare between “sharia principles” and “Islamic sharia” can be seen in the following paragraph (emphasis added):

> *“ ... Therefore, in accordance with its operational basis, i.e.* ***Islamic sharia*** *which is based on the Qur'an, Hadith, and ijma, sharia financing instruments must be aligned with and fulfill the* ***sharia principles****, i.e. among others, transactions conducted by the parties must be fair, lawful, thayyib , and maslahat. In addition, transactions in Islamic finance, which is in accordance with sharia must be free from the following prohibitions: (1) usury, the element of interest or return derived from the use of money to get money (money for money); (2) maysir, namely speculation, gambling, and the attitude of chance; and (3) gharar, an element of uncertainty that is related to delivery, quality, quantity, etc ... ” (General Section of Explanation of Law Number 19 of 2008 on State Sharia Securities).*

The National Sharia Council (DSN) as the institution of new *fatwa* maker introduced the terms of “sharia principles” after the tenth fatwa. The terms of “sharia principles” just appear in the fatwa no. 11/DSN-MUI/IV/2000, dated 13 April 2000 on *Kafalah*, in the consideration section (item c). Meanwhile, Fatwa of DSN Number 1 to 10 has not used the terms of sharia principles, but they used the terms of Islamic law (sharia) (Fatwa of DSN Number 01/DSN-MUI/IV/2000 on *Giro*); Islamic Sharia (Fatwa Number 06/DSN-MUI/IV/2000 on *Istishna'*); (Fatwa Number 09/DSN-MUI/IV/2000 on *Ijarah* Financing; Fatwa Number 10/ DSN-MUI/IV/2000 on *Wakalah*). The inconsistency of the use of the term of "the principle of Islamic teachings" reappeared in Fatwa Number 13/DSN-MUI/IX/2000 on Down Payment in *Murabahah*.

The impact of the use of different meanings of “sharia principles” also continues and has an impact on the definition of Sharia principles in BFSFS (IAI, 2007b). In paragraph 14 of BFSFS (IAI, 2007b) it is stated that (emphasis added):

> *“Sharia is the Islamic law that regulates mankind containing the commands and prohibitions, both concerning the relationship of vertical interaction with God and horizontal interaction with fellow creatures. Generally accepted* ***Sharia principles*** *in muamalah (sharia transactions) activities are legally binding for all actors and stakeholders of entities engaged in sharia transactions ... ”*

In the above quotation, the paragraph looks more explain the meaning of “sharia” than the “sharia principles”. Meanwhile, when using the phrase of “generally accepted Sharia principles in the activities of muamalah (sharia transactions).." it appears that the readers are directed to interpret the sharia principles as "sharia transactions".

The above arguments show that there has been an evolution in the use of of Islamic law, Islamic sharia, sharia transactions, sharia contracts, and sharia principles, and the concepts similar to them in the regulatory, business and financial system in Indonesia. It also impacts on accounting including in the development of the conceptual framework. However, since sharia principles are evolutive and multi-interpretive, it is possible to change the "sharia principles" with meaning of "maqasid shariah".

3. STARTING POINT OF DEVELOPMENT OF THE CONCEPTUAL FRAMEWORK: SELECTING THE OBJECTIVE OF FINANCIAL REPORTING

Determining the objective of financial statements may mark a shift in the orientation of financial accounting practices and become the basis for the preparation of the conceptual framework of financial reporting. The consistency of this paradigm is evident when the US Financial Accounting Standards Board (FASB) revised the objective of financial statement in the Statement of Financial Accounting

Concept (SFAC) number 8 (FASB, 2010) to replace SFAC number 1 (FASB, 1978). Similarly, the Framework for Preparation and Presentation of Financial Statements (IASC, 1989) was then revised and replaced by the Conceptual Framework for Financial Reporting (IASB, 2015). Likewise, the Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI), an institution dedicated to developing conceptual frameworks, accounting standards, governance guidelines and auditing standards for sharia entities, formulates a separate statement regarding the objectives of financial statements in the Statement for Financial Accounting number 1 entitled Objectives of Financial Accounting for Islamic Banks and Financial Institutions (AAOIFI 2001).

FASB, IASB, and AAOIFI put “the decision usefulness” as the objective of the financial statements. Prior to the joint projects between FASB and IASC, the objective of financial statements of the two standard boards is different. However, after the projects were completed, the objective of financial statements of the two organizations is the same:

> *“The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit.” (FASB, 2010, OB2).*

From the quotation, it is clear that the objective of financial reporting is dedicated to only two parties: investors (existing and potential) and creditors (lenders or other creditors). The objectives of financial statements within the “sharia” conceptual framework (AAOIFI and BFSFS) and the “conventional” one (IASC, IASB, FASB) have some similarities and differences. AAOIFI (2015) does not definitely state the objective of its financial statements, but it accommodates the interests of stakeholders, with a primary focus on investors and creditors. The difference is that since the objective of AAOIFI financial statements is specifically designed for financial institutions, there are additional specific phrases, i.e. “investment account holders” and "current accountholders" as can be seen as follows:

> *“The information needs of users of financial reports increase and vary with the increase in the categories of users, for example, investors including equity and investment account holders, creditors including current accountholders, debtors, employees of the IFI (Islamic Financial Institutions), and those who deal with it in any other manner.” (emphasis added)*

Meanwhile, the objective of the IASC financial report (1989) and the objective of the BFSFS report (which was adopted from IASC) was relatively the same, except that BFSFS replaced the concept of “ an entity” (IASC, 1989) into "a sharia entity". The objective of the financial statements of BFSFS (IAI, 2007b, par 30) is as follows:

> *"Provides information pertaining to the financial position, performance and changes in the financial position of an Islamic entity that is beneficial to a large number of users in economic decision making"*

The difference is that BFSFS accommodates various "other objectives" by adding:

(a) to promote compliance with sharia principles in all transactions and business activities;
(b) to provide information on sharia entity compliance with sharia principles, as well as information on assets, liabilities, revenues and expenses incompatible with sharia principles, if any, and how they are used;
(c) to assist in evaluating the fulfillment of the sharia entity's responsibility for safeguarding funds, investing them at a reasonable level of profit; and
(d) to provide information on the rate of return on investment which may be earned by investors and owners of temporary cooperation (*shirkah*) funds; and information on the fulfillment of the obligations of sharia entity on social functions, including the management and distribution of *zakat*, *infaq*, *sedekah*, and waqfs "(IAI 2007b, par. 30).

Thus, the objective of AAOIFI and the IAI-BFSFS formally and substantively still adopts a “conventional” approach, albeit has been modified by sharia principles. Nevertheless, the objective may change over time, as recognized by AAOIFI (2015):

> *"The information needs of users of financial reports increase and vary with the increase in the categories of users, ..."*

Changes in the objective of financial statements may continue as the conditions change (in terms of time and place) and may be in line with sharia. However, when the chosen objective is economic decision-making usefulness, it will strengthen the interests of economic actors in order to fulfill their self-interests (Maurer, 2002). The economic decision-making usefulness is in line with the objectives of capitalism, because it places greater emphasis on profit accumulation (Kamla, 2009, Vinnicombe, 2010). Additionally, the orientation of economic decision-making is also an expression of Western philosophy about economic rationalism (Baydoun and Willet, 2000). It also interfaces with the purpose of developing the objectives of sharia financial statements that are built to support industry practice. According to Ul-Haque (2012), however, the practice of sharia banks has become a trojan horse of secularism in the Islamic finance industry. Hence, Haniffa and Hudaib (2010) came to the conclusion that contemporary Islamic finance has gone from sacred intentions towards secular goals.

4. MAQASHID SHARIA AS THE FOUNDATION OF SHARIA CONCEPTUAL FRAMEWORK OF FINANCIAL REPORTING

Indeed, the determination of the objective of sharia financial statements and the design of the conceptual framework of financial reporting can be a mere world event. On the other hand, since sharia in the field of *muamalah* is considered very flexible and accommodative, it may legitimize not to design an independent sharia conceptual framework. However, this should not prevent us from continuously to seek a stronger sharia foundation. Various efforts have been made, such as in the formulation of BFSFS (IAI, 2007b), where sharia principles have been borrowed as the foundation in formulating the BFSFS. However, as previously discussed, this concept has not been quite robust as a paradigm. It is likely that Maqashid Sharia (MS) is the alternative paradigm can be used to develop sharia conceptual framework.

Maqashid Sharia etimologically consists of two words, namely "maqashid" and "sharia". "Maqashid" is the plural of the single word of "maqshud", which means, among other things, grip, straight path, justice and balance. The term of "sharia" means among others, rules or regulations revealed by God for mankind through his Prophet Muhammad PBUH, which includes *aqidah, muamalah*, and morals. Thus MS is the value that becomes the ultimate goal of the implementation of sharia (Safriadi, 2014). However, what we wish to emphasize here, sharia should not be narrowed down on mere Islamic law. Sharia means the core of the Islamic view of life, which is also a system of ethics and values, and as a methodology to solve the present and future human problems (Sardar, 2003). Based on this broad means, the ultimate goal of sharia is to achieve goodness (*maslahah*) and to avoid and to eliminate various damages.

However, *maslahah* which means cause, opportunity, or a goodness (Abdul-Rahman, 2010) should not be directed only to the interests of individuals, groups, and mere worldly interests and it is necessary to formulate genuine *maslahah* (Abdul-Rahman, 2010), which includes three levels of *maslahah*, namely essential (*darurriyat*), complementary (*hajjiyat*), and embellishments (*tahsiniyat*). Essential (*darurriyat*) includes efforts to guard: *din* (religion), *nafs* (life), *maal* (property), *'aql* (intellect), and *nasl* (offspring). This kind of *maslahah* may also be expanded to social and environmental problems.

Therefore, the use of MS, in particular as the paradigm to define the objectives of sharia financial statements, and in general as the paradigm to build a sharia conceptual framework has a strong foundation. It appears this approach can combine revelation (Qur'an and Hadith) and reason in the form of various legal interpretations (*ijmak, qiyas*) and Islamic ethics which can be called as "sharia principles".

The initial idea of MS as the objective of financial statements has been proposed by Birton (2015), by formulating three levels of financial reporting objectives: primary, secondary and tertiary. The important emphasis of primary objective is "the rights and obligations of various parties", including transactions, events, and economic, social, and environmental activities. So the primary objective of financial statements is:

> *"To provide relevant and trustworthy information including, but not limited to, transactions, events, and/or economic, social and environment, which may have material and non-material impacts, in line with Islamic sharia related to the rights and obligations of various parties as a means of accountability of the trustee to benefit for the universe" (Birton, 2015).*

From this primary objective can be derived a secondary objective to explain the details of the primary objectives, including explaining the measures of the achievement of the primary goal. The secondary objectives of sharia financial statements are:
First, to provide relevant and trustworthy information periodically including, but not limited to, transactions, events, and/or economic, social and environment, which may have material and non-material impacts, in the past, present, and future describing how resources are acquired, managed, and distributed to the various parties in line with the Islamic sharia. *Second*, to provide relevant and trustworthy information periodically including, but not limited to, transactions, events, and/or economic, social and environment, which may have material and non-material impacts, in the past, present, and future describing how obligations are settled with related parties in line with the Islamic sharia" (Birton, 2015).

Meanwhile, the tertiary objective of financial statements is:

> *"To provide information including, but not limited to, transactions, events, and/or economic, social and environment, which may have material and non-material impacts, with ihsan (sincerely and with the best quality) with the worldly and hereafter considerations. The presentation of information with ihsan goes beyond the legal-formal aspect of the sharia entity and the trustee" (Birton, 2015).*

5. CLOSING REMARKS

Based on the previous discussions, it can be seen that various conceptual frameworks (both conventional and sharia) put economic decision-making orientation as the foundation for the formulation of the conceptual frameworks. For the sharia conceptual framework, such approach is problematic because it only accommodates the self-interest of the capitalists, concerned only with economic rationality and leads sharia accounting more secular. Although IAI with its DSAS has put sharia principles as the foundation, but when put economic decision-making usefulness as the objective, the impact is ultimately the same as the conventional conceptual framework. The use of maqashid shariah with three-tier framework seems to give hope of reducing self-interest, the values of capitalism, and secularism within the conceptual framework of Islamic (sharia) financial reporting.

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