

RESEARCH ARTICLE

Financial Performance and Sharia Compliance: A Comparative Analysis of Indonesian and Malaysian Islamic Banks

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Abstracts: The purpose of this paper is to evaluate the financial performance and the sharia conformity of Indonesian and Malaysian Islamic banks. In particular, the study aims to expand the approach of Islamic banks performance assessment by adding two models of sharia conformity measurements, that is, Sharia Conformity and Profitability (SCnP) and Sharia-Compliant Indicator (SCI). The SCnP model unveiled that the studied Islamic banks generally conform with the sharia principles, although they were relatively less profitable. The Malaysian banks performed financially better during the period of study, but the Indonesian Islamic banks conformed more to the Islamic principles. In addition, the SCI Index uncovered different level of disclosure among the Islamic banks.

Keywords: CAMEL rating, Financial reports, Islamic Banks, Sharia compliance, profitability, financial performance

JEL Classifications: E42, G21

In recent years, Islamic financial institutions have grown substantially not only in Muslim majority countries but also in non-Muslim majority countries (Awan & Bukhari, 2011). Even, the European financiers and businessmen have adopted the concept, instruments, and techniques of Islamic finance (Jaffar & Manarvi, 2011). In 2013, there were 500 Islamic banks and financial institutions operating around the world with controlled assets not less than US\$1.7 trillion (Wulandari, Putri, Kassim, & Sulung, 2016). With an estimated rate of 15% annual growth, the role of Islamic banking in financial industry has increased rapidly (Mukhlisin, Hudaib, & Azid, 2015). The popularity of Islamic banks can be seen not only in developed countries but also in developing countries

such as Indonesia and Malaysia. For example, the Indonesian Central Bank or Bank Indonesia (2013a) reported that Islamic financial industry in Indonesia grew 35% in 2012. This was higher than the growth of Islamic financial industry in other countries such as Pakistan, Malaysia, and Middle East countries (Bank Indonesia, 2013a). It indicates a higher acceptance of Islamic bank products in Indonesia and, of course, throughout the world.

Unlike conventional banks, Islamic banks are bounded by double regulations that is commonly applied banking regulations and sharia jurisprudences, and more importantly, encourage real economic activity as well as profit and loss sharing scheme, rather than financial speculation (Ayub & Paldi, 2015; Azmat,

Skully, & Brown, 2014). Islamic banks have more restrictions in term of financial operations and profit generations than their counter-parts, the conventional banks. For example, Islamic banks cannot fund or invest in non-halal (illegal from Islamic point of view) industries like gambling, pornography, non-halal meat (pork and non-halal slaughtered meat), and liquor (Lewis, 2001; Mukhlisin et al., 2015). They are also not allowed to generate profit from interest (*Riba*) and additional charges from their customers.

Based on the above unique character of Islamic banking system, performance measurement of Islamic banks should be different from conventional ones. The stakeholders are not only concerned with financial returns but also how the banks generate their profits. In other words, the evaluation of financial performance of Islamic banks should include both financial and sharia principle dimensions. Thus, a more complex and complicated performance evaluation need to be adopted (Kuppusamy, Saleh, & Samudhra, 2010). More importantly, CAMEL ratio (Capital, Assets Quality, Management, Earning, and Liquidity) and EVA (Economics Value Added), which are the most common measures of bank financial performance, cannot be used solely to examine Islamic bank performance (Antonio, Sanrego, & Taufiq (2012). However, such an incomplete measurement system is applied in many countries including in Indonesia and Malaysia. The call for the combined financial and shariah compliance performance measurement is a way forward as Islamic banks are in competitive banking business environment. It could also motivate financial engineers of Islamic banks to replicate the conventional bank products (Ayub & Paldi, 2015).

With exception of Kuppusamy et al. (2010), there has been very limited studies that were conducted to evaluate the financial performance of Islamic banks by considering the level of banks' compliance to Islamic principles. Kuppusamy et al. (2010) proposed the *Sharia Conformity and Profitability (SCnP)* model as a framework to evaluate both financial performance and the level of sharia conformity of Islamic banks. Those two aspects are evaluated simultaneously. The model classifies Islamic banks into four quadrants according to the level of their profitability and sharia compliance:

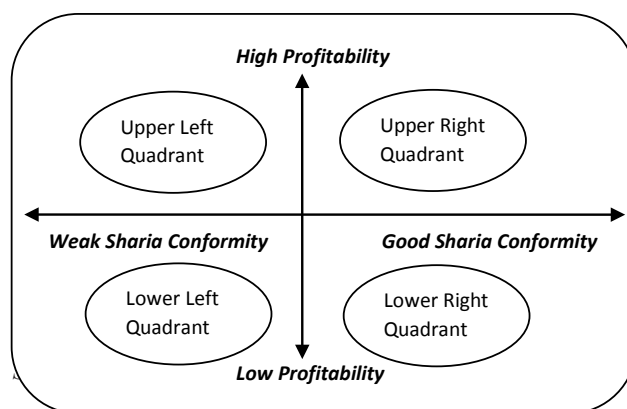


Figure 1: Quadrants of Sharia Conformity and Profitability (SCnP) model.

Furthermore, AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions) has already proposed Sharia Compliant Index to measure how consistent Islamic banks implement the Islamic principles (Ibrahim, Wirman, Nor, & Pramono, 2004). However, far too little attention has been paid to assess the financial performance/condition of Islamic banks regarding their level of sharia adherence. Therefore, this research attempts to fill this gap. In particular, this paper attempts to answer the question, “How different are the level of financial performance and sharia compliance of Islamic banks in Indonesia and Malaysia?” Having this assessment, further policy and standard could be made to improve the evaluation mechanism of Islamic bank performance in which sharia compliance is taken into account and be the main part of the evaluation framework.

Literature Review

In many aspects, Islamic banks have a lot of similarities with conventional banks, except the obligation to follow social equity and sharia principles (Kuppusamy et al., 2010). This section discusses the features or concepts of CAMEL ratio (financial ratio), SCnP, and SCI.

CAMEL Ratio

CAMEL(S) ratio is a traditional financial performance measurement that is widely used to analyze banks' financial performance and health

of banking institutions, including Islamic banks (Rozzani & Rahman, 2013). It has five dimensions of financial measurements – Capital (Capital Adequacy Ratio), Assets Quality (Return on Risk Assets), Management (Net Profit Margin), Earning Capacity (Return on Total Assets), and Liquidity (Loan on Deposit Ratio). CAMEL has been used widely to evaluate the financial performance of banks, including by central banks.

a. Capital. Capital is one of the most important indicators of the financial health in banking system. Capital could be said as the most important element of bank financing. Meanwhile, capital adequacy measures the ability of a bank's capital resources to pay its current liabilities and mitigate unintended implication of risks associated with its assets. According to Misra and Aspal (2013), the value of capital can reflect the ability of banks to cover unexpected losses in the future. The proxy of capital is CAR (Capital Adequacy Ratio) which is indicated by capital to risk weighted assets. This ratio can reflect ability of a bank to anticipate reasonable level of losses in the future. According to Rozzani & Rohman (2013), the appropriate CAR of a bank is less than 11%. It means, that a bank with more than 11% CAR has sufficient capital to support its activities and mitigate insolvency. Meanwhile, the Indonesian Central Bank proposed an 8% CAR as the minimum standard (Ratnaputri, 2013).

b. Assets quality. The second variable of CAMEL is asset quality. The proxy of asset quality is RORA (Return on Risk Assets). This ratio assesses the capability of bank to optimize the utilization of its risky assets to gain (gross) profits.

c. Management efficiency. This variable mirrors the growth and survival of banks. This aspect is useful to indicate management ability in controlling risk. In management efficiency, Net Profit Margin is the proxy which reflects the ability of a bank to generate income from its all economical activities.

d. Earnings. Earnings ratio is used to measure banks' profitability. ROA (Return on Assets) and ROE (Return on Equity) ratio are widely used. The former examines the ability of a bank to generate income relative to average total assets while the latter examines the effectiveness of a bank to use its shareholders'

funds (Kuppusamy et al., 2010). These ratios are used to measure the profitability or the ability of a bank to generate income from its assets.

e. Liquidity. Pandrid (2011 as cited in Jacob, 2013) defined liquidity as the bank's ability to pay their short-term debt. Loan on Deposit Ratio (LDR) is used to evaluate the liquidity of banks. This credit ratio can indicate the bank ability to pay all of its matured loans to the debtors.

According to Rozzani & Rohman (2013), see Table 1. After the ratios for all indicator components have been calculated, they would be put on average weightage and banks would be classified based on their financial performance as follows Rozzani & Rohman (2013):

1. Rating 1 – the value of CAMEL is between 1.0 and 1.4, indicates a sound financial performance
2. Rating 2 – the value of CAMEL is between 1.6 and 2.4, indicates satisfying financial performance
3. Rating 3 – the value of CAMEL is between 2.5 and 3.4, indicates a fair financial performance with some categories of concern
4. Rating 4 – the value of CAMEL is between 3.5 and 4.4, indicates marginal financial performance with a relatively low risk of failure
5. Rating 5 – the value of CAMEL is between 4.5 and 5.0, indicates unsatisfying financial performance with a high degree of failure

SCnP Model

SCnP Model was founded by Kuppusamy et al. (2010). This model combines both conventional ratio and Islamic financial ratio. The basic idea of this model is that both conventional and Islamic financial indicators can evaluate the financial performance of Islamic banks as they have a lot of similarities with conventional banks (Kuppusamy et al., 2010).

a. Sharia conformity. The Sharia conformity measurement evaluates the conformity of banks' operation to sharia principles (Kuppusamy et al., 2010). It has three dimensions, namely Islamic

Table 1: *Classified Items of CAMEL*

Items	Ratio	Rank				
		1	2	3	4	5
Capital	$CAR = \frac{\text{Capital}}{\text{Risk Weighted Asset}} \times 100\%$	Above 11%	8%-11%	4%-8%	1%-4%	Below 1%
Assets	$\text{Asset Quality} = \frac{\text{Non - Performing Loans}}{\text{Total Loans}}$	Below 1.5%	1.5%-3.5%	3.5%-7%	7%-9.5%	Above 9.5%
Management	$\text{Management Quality} = \frac{\text{Personnel Expenses}}{\text{Average Assets}}$	Below 25%	1.5%-3.5%	3.5%-7%	7%-9.5%	Above 9.5%
Earnings	$ROA = \frac{\text{Income Before Tax X}}{\text{Total Assets}} 100\%$	Above 1.5%	1.25%-1.50%	1.01%-1.25%	0.75%-1.00%	Below 0.75%
	$ROE = \frac{\text{Income Before Tax X}}{\text{Total Equity}} 100\%$	Above 22%	17%-21.99%	10%-16.99%	7%-9.99%	Below 6.99%
Liquidity	$\text{Liquidity} = \frac{\text{Liquid Assets}}{\text{Deposit and Short Term Funding}}$	Below 60%	60%-65%	65%-70%	70%-80%	Above 80%

Source: Rozzani & Rohman (2013).

Investment, Islamic Income, and Profit Sharing Ratio. Firstly, Islamic Investment measures the portion of investment invested in halal products, that is, free from *riba*, *gharar*, and gambling (*maysir*). In this term of halal products, Islamic banks are obliged to disclose truthfully investments that are considered halal (Kuppusamy et al., 2010). The Islamic investment is calculated as follows:

$$\text{Islamic Investment} = \frac{\text{Islamic Investment}}{\text{Total Investment}} \quad (1)$$

Secondly, the Islamic income ratio examines the portion of Islamic income over total income. Kuppusamy et al. (2010) defined the Islamic income as bank income generated from investments that comply with sharia principles. It means that Islamic banks have also haram income (derived from prohibited sources) that could be generated from interest of saving in other banks, for example, the central bank. The value of this income needs to be provided as well as how the banks deal with it (Kuppusamy et al., 2010). Thus, Islamic income ratio can be calculated as follows:

$$\text{Islamic Income} = \frac{\text{Islamic Income}}{\text{Islamic Income} + \text{non - Islamic Income}} \quad (2)$$

Thirdly, profit-sharing ratio reflects how far Islamic banks have successfully met the objective of sharing not only profit but also loss with investors. Profit

sharing is the uniqueness of Islamic bank that might be difficult to be implemented in practices. It can be seen from the number of *Mudarabah* (silent partnership) and *Musharakah* (partnership) products and their portion in the Islamic bank that reflects the practice of profit sharing in the banks. These financing products are supposed to be the main instruments of the Islamic banks to distribute the wealth to the society (Ibrahim et al., 2004). Therefore, the ratio is computed as follows:

$$\text{Profit Sharing Ratio} = \frac{\text{Mudarabah} + \text{Musharakah}}{\text{Total Financing}} \quad (3)$$

b. Profitability. SCnP model also uses profitability to measure bank's financial performance. In SCnP, profitability of banks is measured by ROA, ROE, and Profit Margin. Later on, the average values of these ratios are used to measure the banks' profitability in this model (SCnP). Following are the formula to compute the ratios:

$$ROA = \frac{\text{Net Income}}{\text{Average Total Assets}} \quad (4)$$

$$ROE = \frac{\text{Net Income}}{\text{Stockholder's Equity}} \quad (5)$$

$$\text{Profit Margin Ratio} = \frac{\text{Net Income}}{\text{Total Operating Revenue}} \quad (6)$$

Finally, the data generated from sharia conformity and profitability measurements are categorized into a graph based on following procedure (Kuppusamy et al., 2010):

1. If the banks have a high profitability (>0) but low sharia conformity level (<0), locate them at quadrant I (Upper Left Quadrant),
2. If the banks have a small profitability and a sharia conformity level (<0), locate them at quadrant II (Lower Left Quadrant),
3. If the banks have a high score in both profitability and the sharia conformity level (>0), locate them at quadrant III (Upper Right Quadrant),
4. If the banks have a high score in sharia conformity level (>0), but not in profitability (<0), locate them at quadrant IV (Lower Right Quadrant).

Sharia Compliance Indicator

Nowadays, there is a call for the development of indices to evaluate the performance of Islamic banks as well as their ability to meet their objectives (Ibrahim et al., 2004). Moreover, AAOIFI (Accounting and Auditing for Islamic Financial Institutions) in Accounting, Auditing and Governance Standards for Islamic Financial Institutions (AAGSIFI) has demanded all Islamic financial institutions to provide information related to the compliance of their activities with Islamic principles (Asrori, 2011).

Ibrahim et al. (2004) have proposed Islamicity indices that consist of two elements, namely Islamicity Disclosure Index and Islamicity Performance Index. The former assesses how well Islamic banks disclose the information to help their stakeholders in evaluating the sharia compliance, corporate governance, and social/environment of the Islamic banks. Meanwhile, the latter emphasizes on the product performance of Islamic banks that includes profit-sharing performance, zakat performance, and equitable distribution performance (Ibrahim et al., 2004). This study used Islamicity Disclosure Index because it focused on examining the disclosure practices of Islamic banks. In particular, the SCI is used as this study aimed to assess how well the studied Islamic banks provide information about the compliance/adoption of Islamic values and practices in their financial reports. The following sections will elaborate further how SCI is used in this study.

According to Ibrahim et al. (2004), there are three dimensions of SCI as follows:

a. Sharia Supervision Boards (SSB)

SSB is a religious supervisory council, which is responsible for ensuring that the Islamic banks' activities do not contradict the Islamic ethical standards (Ibrahim et al., 2004). It monitors the banks' adherence to Islamic principles. This council has a crucial role so that its existence in Islamic banks is mandatory (Ibrahim et al., 2004). In fact, AAOIFI has obligated Islamic banks to disclose procedures of the SSB appointment, its composition, selection and dismissal, SSB report and identification of actual activity conducted of the SSB (as cited in Ibrahim et al., 2004). In addition, Ibrahim et al. (2004) have added other requirements, that is, the name, educational background, and the experiences of the SSB members that should be disclosed in annual reports of an Islamic Bank.

b. Basic information on banks mission statements

As mentioned before, Islamic banks have a different objective than conventional banks, that is, Islamic code of ethics (Ibrahim et al., 2004). Thus, Ibrahim et al. (2004) believed that each Islamic bank has to provide clear information about its objective vision, and mission in the annual report.

c. Financial statement

As Islamic banks are different with conventional banks in terms of their objective, financial report of Islamic banks should provide more information than conventional banks (Ibrahim et al., 2004). Ibrahim et al. (2004) argued that financial statement of Islamic banks should not focus on the needs of certain group only, but it should cover the demand of all users: stakeholders, creditors, government and social as a whole. In fact, Islamic banks' financial reporting should include several principles elements to attain the ultimate objectives of Islamic banks (Ibrahim et al., 2004). In this context, Islamic banks should report information that helps the users to assess how far their operations adhere to Islamic principles. Based on this assumption, Ibrahim et al. (2004) proposed nine items/features that should be disclosed in financial report of Islamic banks and can be used to examine the level of sharia

principle implementation in the bank operations. These required information are collected and developed based on AAOIFI standards (2002) on Governance Standard for Islamic Financial Institution (GSIFI) as follows:

1. Identification of Islamic investment
2. Identification of non-Islamic investment
3. Identification of Islamic revenue
4. Identification of non-Islamic revenue
5. Provide the statement of sources and uses of funds in *Zakat* and charity
6. Provide the statement of sources and uses of funds in the *qardh* funds
7. Identification sources of revenue
 - excluded revenue attributable to depositors
 - excluded revenue attributable to *Murabaha* financing
8. The adoption of current value whenever it is possible
9. Value Added Statement

The SCI is computed based on how much the information provided in annual report of the Islamic banks. If the required information is provided, the bank will be given score of 1, and 0 if they do not publish. Following is the formula to calculate the SCI:

$$SCI = \frac{\sum_{i=1}^{n=j} X_{ij}}{n_j} \quad (7)$$

X = 1 if it is published, and 0 if it is not published ($0 \leq SCI \leq 1$)

n = amount of all items

Lastly, the total score is used to classify the banks based on their SCI as follow:

Table 2. *Sharia-Compliant Indicator*

Score	Rank
0 – 25 %	Very Low
26 – 55 %	Low
56 – 80 %	Middle
81 – 90 %	High
91 – 100 %	Very High

Source: Murtiyani (2008)

Research Method

This study aims to evaluate the financial performance and sharia compliance of Indonesian and Malaysian Islamic banks as well as to find the potential pattern amongst them. In this study, the data has been collected from financial reports/-annual reports of the selected Islamic banks.

The population in this research is all of Islamic Banks in Indonesia and Malaysia. In 2014, there were 11 Islamic banks registered in the Indonesian Central Bank, whereas 16 Islamic banks in total operated in Malaysia. Unfortunately, not all banks can be studied as the accesses to their online financial reports were not obtained. Most of the financial reports of the studied Islamic banks were obtained from the Central Banks—Indonesian Bank (BI) and State Bank of Malaysia (BNM)—during the period 2011–2013 and the rest from their websites.

This study used annual reports (financial reports) of seven Indonesian Islamic banks (or 72.72% of total Islamic banks in Indonesia) and 11 Malaysian Islamic banks (accounted for 68.75% of total Islamic banks in Malaysia). The following is the list of the studied Islamic bank:

Table 3. *List of Studied Islamic Banks*

No	Malaysian Banks	Indonesian Bank
1.	Asian Finance Bank Berhad	Bank BNI Syariah
2.	Bank Muamalat Malaysia Berhad	Bank Muamalat Indonesia
3.	Bank Islam Malaysia Berhad	Bank Syariah Mandiri
4.	CIMB Islamic Bank Berhad	Bank Mega Syariah
5.	HSBC Amanah Malaysia Berhad	Bank BCA Syariah
6.	Hong Leong Islamic Bank Berhad	Bank BRI Syariah
7.	Kuwait Finance House (Malaysia) Berhad	Bank Panin Syariah
8.	Public Islamic Bank Berhad	
9.	RHB Islamic Bank Berhad	
10.	Standard Chartered Saadiq Berhad	
11.	OCBC Al-Amin Bank Berhad	

Result and Discussion

This part provides the results of CAMEL Rating, SCnP, and SCI. Later on, comparative descriptive analysis is employed to discuss the results from Indonesian and Malaysian Islamic banks.

Comparative Performance of Islamic Banks in Indonesia and Malaysia

The analysis of CAMEL Rating. The computation of CAMEL rating of the studied banks found that the Indonesian and Malaysian Islamic banks have similar financial performance and condition. The CAMEL rating of the Indonesian banks have gradually decreased from 2.57 to 2.86 between 2011 and 2013. This indicates that the financial performance of the Indonesian banks has declined. Based on the CAMEL computation, a declining liquidity of the Indonesian banks between 2011 and 2013 could be the main reason. In contrast, the CAMEL rating of the Malaysian bank has grown between 2011 and 2013 from 3.18 to 2.64. In fact, there were some banks which have received a rating of 2nd, for example, Bank Islam Malaysia Berhad and HSBC Amanah Malaysia Berhad. This can be associated with the recovery of the world economy from the financial crisis and the offer of new Islamic banking products.

Table 4. *Average CAMEL Rating*

Year	Average CAMEL Rating	
	Indonesian Banks	Malaysian Banks
2011	2.57	3.18
2012	2.67	2.91
2013	2.86	2.64
Average	2.70	2.91

The analysis of SCnP. In this regards, both Islamic banks in Indonesia and Malaysia have high level of sharia conformity. This judgement is made according to their position in the SCnP quadrants. They are generally in the right quadrant, which indicate that the banks have good level sharia compliance. However, the financial performances of the studied banks have a relatively smaller profitability ratio. In this context, the Malaysian banks have higher profitability ratios but smaller sharia conformity level as compared to the Indonesian banks.

Table 5. *Average SCnP Results of Indonesian and Malaysian Banks*

	Sharia Conformity	Profitability
Indonesia		
2011	75.96%	6.57
2012	77.29%	11.28
2013	78.23%	8.62
Malaysia		
2011	68.19%	10.68
2012	68.90%	10.46
2013	69.26%	16.21

From Table 5, it can be seen that the adherence to sharia's level of Islamic banks in Indonesia is better than Malaysia. The Indonesia banks have more than 75% of sharia compliance and it increases every year, while Islamic banks in Malaysia only comply for no more than 69.26%. This can be associated with the lack of distribution of *Mudaraba* and *Musharaka* financing in the Malaysian banks compared to the Indonesian banks. In fact, there are some Malaysian Islamic banks which do not report this type of financing. Moreover, the Malaysian Islamic banks have not reported their non-halal income in revenue element within the research period. Regarding the non-halal income and investment in the Malaysian Islamic banks, for example, Jan and Marimthu (2015) indicated that there are some concepts that are not in line with sharia law practiced by Malaysian Islamic banks, such as Bay-al-Dayn and Dawat to ajjal, in which many Islamic scholar disagree with.

Based on the SCnP 2011 chart, it can be clearly seen that most of the Islamic banks are in the third quadrant (Upper Right Quadrant). It means that all the banks have both high profitability and high level of sharia compliance, except for Kuwait Finance House (Malaysia) Berhad which has negative profitability ratio but high level of sharia compliance. In 2012, there seems to be slight changes in the position of the SCnP chart of the Indonesian Islamic banks and vice-versa for the Malaysian banks. This shift can be associated with the fall of profitability of some Malaysian banks that declined the X axis. In the SCnP 2013 chart, the increase of profitability is seen from the Malaysian Banks (Wasiuzzaman & Gunasegavan, 2013; Ashraful & Chowdhury, 2015). This can be associated with the recovery of world economy from financial crisis and the offer of new Islamic banking products. Consequently, it changed the SCnP chart where all

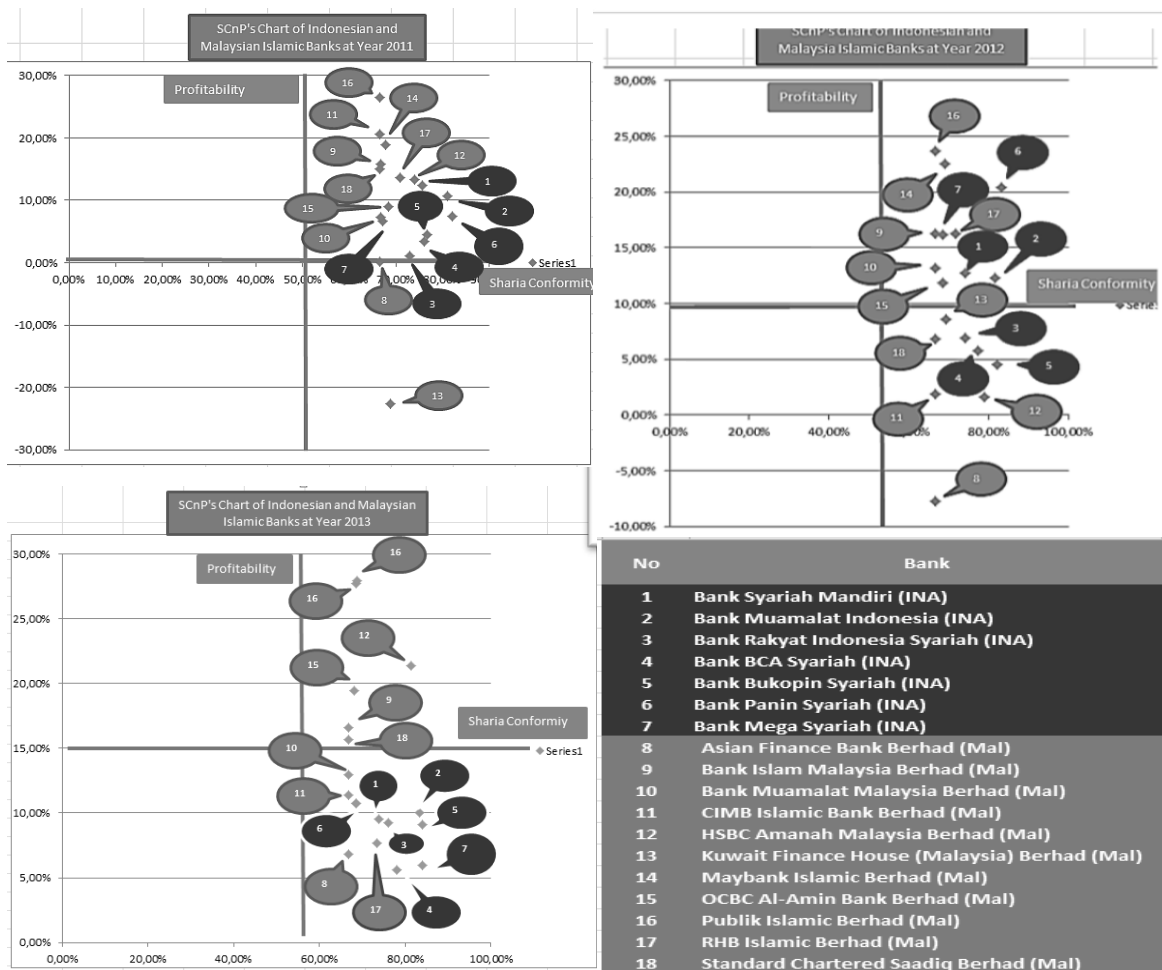


Figure 2. SCnP Quadrants.

Indonesian banks move to the fourth quadrant (Upper Right Quadrant). In contrast, six Malaysian banks are in the third quadrant (Upper Right Quadrant).

In short, the movement of the banks in SCnP quadrants between 2011 and 2013 is stimulated by the fluctuation of the Islamic banks' profitability particularly the profitability of the Malaysian banks. Meanwhile, the level of sharia compliance of each Islamic bank involved in this study is relatively unchanged. Lastly, the Indonesian banks have a little higher level of sharia compliance but smaller profitability than the Malaysian banks.

Several studies have inquired the indication of a trade-off between profit and sharia compliance of Islamic banks. Waemustafa & Sukri (2013) reported a dilemma in Malaysian Banks in terms of gaining profit and adhering sharia principles. For example, the conformability of advance penalty charges on

house buyer imposed by Islamic banks today is questioned (Waemustafa & Sukri 2013). Meanwhile, the replication of synthetic products, namely, financial derivatives and structured products based on sale of debts, receivables, and currency exchanges, in Islamic banks potentially diminish the core values of Islamic finance (Ayub & Paldi, 2015).

The analysis of SCI. The SCI is one element of the Islamicity Disclosure Index that is proposed by Ibrahim et al. (2004). By using this indicator, this study found that each Islamic bank has different compliant score, but it does not change much between 2011 and 2013. It means that the information about sharia compliance level in their financial reports seem to be unchanged.

Furthermore, Islamic banking in Indonesia has a relatively higher SCI than the Malaysian Islamic bank in average. On average, the Indonesian Islamic

Table 6. *The Average Result of Sharia-Compliant Indicator (SCI)*

Item	The Indonesian Banks	The Malaysian Banks
I. Sharia Supervisory Board (SSB)		
1. The Appointment of SSB	0.57	0.00
2. The Report of SSB	1.00	1.00
3. Identification of actual activity conducted	0.86	1,00
4. The SSB members' background and profile	1.00	0.36
II. Basic Information		
1. The Vision, Mission, and Objectives	1.00	0.18
2. Principal activity	1.00	1.00
3. Financial Statement		
4. Identification of Islamic Investment	1.00	1.00
5. Identification of non-Islamic Investment	0,00	0,00
6. Identification of Islamic Revenue	1.00	1.00
7. Identification of non-Islamic Revenue	1.00	0.00
8. Provide the statement of sources and uses of funds in Zakat and charity	0.71	0.00
9. Provide the statement of sources and uses of funds in the <i>qard</i> funds	0.71	0.18
10. Identification sources of revenue:		
a. excluded revenue attributable to depositors	1.00	1.00
b. excluded revenue attributable to <i>Murabaha</i> financing	0.86	1.00
11. The adoption of current value whenever it is possible	0.29	0.82
12. Value added statement	0.00	0.00
Average	80%	56.97%
The highest value	93%	67%
The smallest value	73%	53%

Source: Research Data (2014).

banks have reported 80% of items in SCI. The Bank Muamalat Indonesia and BRI Sharia have disclosed almost all Islamic value required by the SCI (93%), while Bank Syariah Mandiri, BCA Syariah, Bank Mega Syariah, and Bank Bukopin Syariah have the smallest SCI (73%). Meanwhile, the Malaysian Islamic banks provided less information related to the implementation of Islamic principles. On average, the SCI value of Malaysian Islamic banks in 2013 is 56.97%. The highest SCI (67%) is from Bank Islam Malaysia Berhad, whereas the lowest SCI (53%) can be seen in Asian Finance Bank Berhad, HSBC Amanah Malaysia Berhad, Maybank Islamic Berhad, OCBC Al-Amin Bank Berhad, Public Islamic Berhad and Standard

Chartered Saadiq Berhad. Thus, the Indonesian Islamic Banks could be said to disclose much more information on Islamic principles' implementation than the Islamic banks in the neighbourhood country, Malaysia.

Moreover, the SCI computation has unveiled also some important findings. Firstly, similarities or common practices can be found between the Indonesian and Malaysian banks. Their 2013 annual/financial report provided information SSB report, principal activity, Islamic investments, Islamic revenues, and separated reports in revenue attributable to depositors sufficiently. In contrast, both groups of Islamic banks have not provided (adequately) information about their non-Islamic investments and value added statement,

although these information required by the AAOIFI (Ibrahim et al., 2004).

Secondly, the financial reports of Indonesian Islamic banks provided relatively much more information about their SSB compared to the financial reports of Malaysian Islamic banks. For example, only few Malaysian banks disclosed information about their SSB profiles and, in fact, no information provided about how the SSB is appointed.

Thirdly, it seems that the information related to vision, mission, and objectives, Zakat and charity and *qardh* funds of the Islamic banks are not common to be published in the financial reports of Malaysian Islamic banks. In contrast, this information seems to be customary in the financial reports of Indonesian Islamic banks. Therefore, the differences and similarities of the financial reports between both groups of Islamic banks are easily noticed.

Furthermore, the non-disclosure of the sources and uses of *zakah* and sources and uses of funds *qardh* is because Islamic banking in Malaysia is not instructed to report both items. In Financial Reporting for Islamic Banking Institutions Part D No. 15 (2) of the Publication Requirement (Bank Negara Malaysia, 2013), the items that are ordered to be reported by the Islamic banks in Malaysia is the statement of financial position, comprehensive income statement, statement of changes in equity, cash flows report, and Sharia Committee report (the Sharia Supervisory Board).

On the contrary, the Indonesian Islamic banks have to follow PAPSI 2013 (*Pedoman Akuntansi Perbankan Syariah Indonesia* or Indonesian Islamic Bank Accounting Guidelines) that require them to participate reporting sources and uses of zakah and sources and uses of funds *qardh*/charity fund. These requirements are stated in PAPSI No. 2 of the Financial Statements of Islamic Bank, in Section II.1 Points C in General Provisions Financial Statements (Bank Indonesia, 2013b).

Conclusion

As the Islamic banks have growth rapidly, a more comprehensive performance is required. Unlike conventional banks, the Islamic banks have more complex financial performance and principles to follow. Indeed, the banks are required both to serve the

needs of different stakeholders and more importantly, to ensure that their activities are not contradicted with Islamic principles (Ibrahim et al., 2004). Thus, this study examined and compared both financial performance and Sharia compliance the Indonesian and Malaysian Islamic banks.

Firstly, the CAMEL computation indicated that both Indonesian and Malaysian Islamic banks have financial problem as their rating is 3 in average. Some banks have a good performance, whereas the others perform poorly. This unexpected CAMEL rating is mostly attributed with a low earnings ratio (profitability) among the Islamic banks. This finding is consistent with Jaffar and Manarvi (2011) and Kamaruddin and Mohd (2013) studies who found that Islamic banks have lower profitability and efficiency compared to the conventional banks.

Secondly, the SCnP model showed different performance between the Indonesian and Malaysian Islamic banks. The former have a higher sharia compliance level but a smaller profitability than the latter in average. However, to examine whether a trade-off between profitability and Sharia compliance existed in Islamic banks, a quantitative based research that involved much more Islamic banks is imperative.

Thirdly, the Indonesian Islamic banks have relatively higher SCI than the Malaysian banks. This result reflects that the Indonesian Islamic banks are more concerned on the disclosure of sharia principle implementation in their financial reports than the Malaysian banks. The rapid and comprehensive financial reporting standards for Islamic banks in Indonesia could be the reason behind the higher level of Indonesian banks' SCI.

Profit maximization could be the rationale behind why Islamic banks engage in sharia non-compliance activities (Waemustafa & Sukri, 2013). Operating in a fierce completion, Islamic banks are demanded to offer innovative products that might be not fully consistent with Sharia principles. Thus, the implication of this study is that the stakeholders are urged to use both financial performance and Sharia compliance indicator to evaluate Islamic banks.

Due to the type of research design, especially the number of data, this study has some limitations. Firstly, data is collected fully from financial reports or annual reports. Thus, the results are limited and explanations behind about the results cannot be prevailed. For example, the reasons behind why Indonesian banks

have low profitability ratios or why the Malaysian banks disclosed limited sharia-based information cannot be uncovered. Secondly, the sample is very small and period of study is short. Thus, a generable finding could not be justified from this study. Accurate picture of Islamic banking in both countries perhaps cannot be provided in this study.

Based on above limitations, we recommend further investigations on the trade-off between financial performance and sharia compliance in Islamic banks. Moreover, a more qualitative research could be done in the future to understand why there are differences of financial reports' content particularly in Islamic principles implementation in the Islamic banks. Lastly, performance and Sharia compliance of other Islamic financial institutions such as Islamic assurance and Islamic pawn-shop are still limited and needs further research.

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