Predictability of the Profit Post Revision of Financial Accounting Based on the Supply Chain Management: Empirical Study from Islamic Banks in Indonesia

Sri Wahyuni[1], Pujiharto[2], Zulfikar[3]
[1,2]Universitas Muhammadiyah Purwokerto, Indonesia
[3] Universitas Muhammadiyah Surakarta, Indonesia
[1]yuni_7067@yahoo.co.id
[2]p_harto@yahoo.co.id
[3]zulfikar@ums.ac.id

Abstract- **Thuis paper investigates the impact of supply chain integration on organizational performance in Indonesian banking sector. For this purpose the earnings predictability of Islamic banks in Indonesia are examined by investigating earnings volatility and the factors that influence it. In particular: 1) to examine the volatility of Islamic bank earnings; 2) investigate the effect of earnings volatility on the discretion of Islamic bank managers in determining the fair value of credit / financing; and 3) examine the positive effect of the allowance for possible losses on earning assets on the income smoothing of Islamic banks. This research is a quantitative study with the object of Islamic commercial banks in Indonesia with a research period of 2013-2016. The data used in the form of secondary data that is annual BUS report and then analyzed using multiple linear regression. The analysis shows that: 1) There is earnings volatility in Islamic banks after the revision of PSAK 50/55; 2) Earnings volatility does not affect managers' discretion in determining the fair value of financing; 3) Allowance for possible losses on earning assets has no positive effect on the income smoothing of Islamic banks; 4) Self-assessment of corporate governance can reduce the income smoothing of Islamic banks. The results of this study provide significant contributions to managers of Islamic banks, Bank of Indonesia, and Badan Penyusun Standar Akuntansi Keuangan Syariah that revised PSAK 50/55 causes volatility of earnings generated, but in Islamic banks, volatility does not cause manager discretion in determining the fair value of financing, like a conventional bank.**

Keywords- *Predictability, Supply Chain Management, The Profit Post Revision, Financial Accounting Standards, Empirical Study, Islamic Banks*

1. Introduction

Supply chain integration is divided into two categories: customer and internal integration. The development of Islamic banks is increasingly rapid along with the issuance of the latest regulations that specifically regulate Islamic banking, namely Law No.21 of 2008. Islamic Banks are financial/banking institutions whose operations and products are developed based on the Qur'an and Hadith. Based on 2015 Sharia Banking Statistics data the growth of sharia banks shows encouraging conditions. At the end of 2009, there were only 6 Islamic commercial banks with 711 branch offices. At the end of 2015, there were 12 Islamic commercial banks with more than 2000 branch offices and 22 Islamic business units with more than 300 branch offices. However, based on the [1-5], the sharia banking market share never exceeded 5% of the total national banking assets. OJK said the low market share was due to the weak competitiveness of Islamic banks against conventional banks. According to [6-9] states that the low market share is caused by the low interest of the community to save and invest, and make Islamic banks as a source of business financing. Sharia bank managers must maintain the level of capital and the level of bank liquidity risk they lead due to limitations in investment options and limited access to interest-free interbank access [10]. The manager of an Islamic bank must maintain a favorable rate of return for customers, but also must take into account the loss from the financing channeled [11]. Furthermore, as a basis for profit sharing in a production sharing contract, information on profits is crucial, so this research is important to do.

2. Literature Review

The intention of supply chain management is to eliminate communication barriers and remove redundancies throughout coordinating, monitoring and controlling processes in the organization. Supply chain integration attempts to establish the inter links between each component of the chain, to help better decision making and to allow all components of the chain to cooperate in a more flexible way. These steps produce supply chain visibility and recognition of bottlenecks [12-15]. The CAR, NOM, and BI rates variables have a positive influence on the profitability level of Bank

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Syariah Mandiri. The NPF and Operational Income Operating Expense have a negative influence on the profitability level of Bank Syariah Mandiri [16]. Research conducted by [15] shows that Return on Assets (ROA) has a negative effect on Capital Adequacy Ratio (CAR). Meanwhile financing to Deposit Ratio (FDR) has a negative effect on Capital Adequacy Ratio (CAR) and size has a negative effect on Capital Adequacy Ratio (CAR). Furthermore, net Interest Margin (NIM) has a positive effect on Capital Adequacy Ratio (CAR) and lastly Deposit (DEP) has a negative effect on Capital Adequacy Ratio (CAR).

[12] examine whether Islamic bank managers tend to do efficient earnings management or opportunistic earnings management. The samples tested were 81 banks worldwide taken from the Financial Institutions Information (IBIS) Database, with an observation period of 2000-2009. There is a significant relationship between EM proxies of future profitability. Islamic bank managers do not use their discretion to manipulate their profits opportunistically but use their discretion to communicate their profits through information inside IBIS. In [17-21] test the indication of earnings management through income smoothing by Islamic banking and the factors that influence it. Earnings management is measured by total loan loss provision. Income smoothing is measured by the Eckel Index. Period of 2009-2011 regency. As a result, Islamic banking in Indonesia manages earnings through income smoothing. The factors that influence the management of Islamic banks to smooth income are the amount of financing, financing risks, and profitability.

2.1 Effect of Profit Volatility on Discretion in Sharia Banking Management

Earnings volatility shows the level of profit fluctuations obtained by banks from their operational activities for several periods. Earnings volatility also shows the level of risk, which is reflected in the magnitude of the deviation of the high and low profit earned by banks during a certain period [22, 23]. According to [8-10] the greater volatility of earnings will reduce the quality of reported earnings. This is because earnings which tend to fluctuate will make it difficult for users of financial statements to predict future company profits. Earnings estimates can be biased and be inaccurate in fluctuating earnings conditions. Stable earnings are important for banks because high-profit volatility at one bank can have a domino effect, high-profit volatility causes bank performance to decline and impacts on other aspects, such as increased liquidity risk and bank reputation. Therefore, managers in the banking sector and regulators have an interest in maintaining minimum earnings volatility in banks [11].

[3] proved an increase in earnings volatility in the banking sector after the adoption of revised PSAK 50/55 (revised 2011). This is due to the revision of PSAK 50/55 (revised 2011) requiring banks to use fair value accounting to measure and report financial instruments. Banking institutions have a significant impact because most of the assets and liabilities at banks are financial instruments [1]. Especially in Islamic banks, according to [20], the profit-sharing agreement in Islamic banks is predicted to cause fluctuations in earnings. This fluctuation in profit is caused by the limitations of financial and investment instruments that are in accordance with sharia principles so that Islamic banks face liquidity risk. In addition, Islamic banks as the guarantor of funds (shahibul mal) bear the risk of financing the funds channeled, where losses are often borne by Islamic banks [14],[20],[23]. To overcome the impact of earnings volatility, bank managers are suspected of using their discretion in using accounting policy methods and estimates to obtain profits with stable fluctuations [4],[11],[22].

According to [3], this management discretion is carried out by determining the amount of allowance for impairment losses (CKPN). CKPN is a reflection of determining default credit risk in the future. Based on previous research, earnings volatility is predicted to increase the risk for banks. To overcome this, it is suspected that bank managers use their discretion in determining the amount of CKPN value as a reflection of anticipated credit default risk in the future.

2.2 Income Smoothing in the Banking Sector by Supply Chain Strategy

One method used by bank managers to overcome earnings volatility is to smooth income using the cost of earning losses on productive assets [1],[2],[5],[6],[11],[13],[16],[22]. This is due to the cost of earning losses on productive assets (Loan Loss Provision / LLP) is a reflection of the anticipated loss and risk management of productive assets by bank managers [2]. According to [22], Loan loss provision is a cost that is recorded to increase the allowance for possible losses (Loan Loss Allowance) and reduce profit before tax for the period. The increase in the allowance for credit losses will reduce the amount of net income reported, otherwise the delay in charging the allowance for losses will increase net income. Bank managers have separate information related to the risk of default on each credit or financing provided to customers, so the manager's consideration and discretion are needed to estimate the size of LLP [22].

Islamic banks have greater risk factors compared to conventional banks. This is due to interest-free transactions making the types and investment choices that can be made by Islamic banks are less when compared to conventional banks [10],[20]. In [14] argues that fluctuations in returns obtained through the profit-sharing system increase the tendency for a moral hazard to occur. In cooperation with the profit-sharing system, there is a business risk in the form of potential misuse of financing by the debtor. Islamic banks as the owner of funds (principal) cannot fully control the behavior of the debtor (agent), which in turn will increase the potential for default (default). To overcome this, the manager of Islamic banks will reserve profits to flatten the level of return to customers or to cover losses. The National Sharia

Council of the Indonesian Religious Leader (DSNMUI) issued fatwa no. 87 / DSN-MUI / XII / 2012 concerning income smoothing methods in Islamic banks. This fatwa was issued with the consideration that if an Islamic bank is in a condition there is a strong suspicion of facing the risk of transfer or withdrawal of customer funds due to the level of compensation that is not competitive and reasonable (displaced commercial risk).

Islamic banks can make policies known as income smoothing methods in the form of income smoothing without forming a profit adjustment reserve, and income smoothing by forming a profit adjustment reserve (Profit Equalization Reserve / PER). Determination of the conditions for this transfer risk is determined by the manager of the Islamic bank based on the operational guidelines (standard operating procedure / SOP) of the bank concerned by taking into account the opinion of the Sharia Supervisory Board (DPS). As such, bank managers have the authority / discretion in determining the risk of displaced commercial risk with oversight by the DPS. Furthermore, [14] argues that this method of income smoothing is pursued with the intention that Islamic banks can have returns that are comparable to conventional banks.

2.3 Income Smoothing and Self-Assessment in the Implementation of Corporate Governance (CG)

The level of compliance reflected in the implementation of Corporate Governance in the bank will affect the bank manager in smoothing income. The score of the results of the self-assessment of CG implementation is expected to be able to reflect the implementation of CG banking comprehensively. This is possible because all elements of Good Corporate Governance assessment are included in the self-assessment component [14] and Wijayanti & Diyanti (2017) [23] prove that the better the self-assessment ranking of CG implementation, the lower the level of leveling profit made.

3. Research Method

The purpose of this study is to analyze the predictability of Islamic bank earnings and the factors that influence it. Earnings predictability in this study was analyzed by investigating earnings volatility that can affect the accuracy of earnings predictions by users of financial statements [8],[9]. According to [23] earnings volatility in the banking industry increased due to the revision of PSAK 50/55 (revised 2011) which required reporting of financial instruments using fair value. Banking institutions experience a considerable impact on earnings volatility because most assets and liabilities at banks are financial instruments [1]. To overcome the impact of earnings volatility, bank managers allegedly used discretion in the form of income smoothing to produce a more stable profit [22]. While the alleged existence of income smoothing in this study was conducted by analyzing the use of loan loss provision (LLP) which is used as a way to smooth income by conventional banks. Well, is the loan loss provision (LLP) also a means of leveling profits by Islamic banks, this phenomenon is interesting to study.

4. Result and Discussion

Sharia bank manager's discretion in determining the fair value of credit/financing is measured by calculating the amount of discretion in determining the amount of allowance for impairment losses (CKPN) or loan loss allowance (LLA). Credit/financing fair value discretion (DAKRN) is a risk of default (default) by Islamic banks when there is an increase in the risk of bad credit and a decline in the fair value of credit/financing [23]. The model developed to calculate DAKRN refers to the research model conducted by Wijayanti & Diyanti (2017) [23] as follows:

$$\mathbf{LLA_{it}: \alpha + x1\ LOAN\ it + X2NPL_{it} + X3\Delta NPL_{it-1} + e} \quad (1)$$

DAKRD is obtained from the error value obtained from the model.

This approach is constructed from accounts in the financial statements. The following table 1 shows the discretion in the fair value of Islamic commercial banks/loans in Indonesia for the period 2011-2016.

Table 1. Discretionary Fair Value of Credit / Financing of Islamic Banks 2011-2016.

Year	2011	2012	2013	2014	2015	2016
Average	0,330	0,203	0,079	-0,036	-0,348	-0,228
Minimum	-0,676	-0,690	-1,830	-2,357	-2,265	-2,698
Maximum	0,951	0,665	0,963	0,787	0,743	0,814

Source: secondary data processed

The average sharia banking DAKRD in Indonesia in the 2011-2016 period experienced fluctuations. The highest average DAKRD occurred in 2011 in the amount of 0.330 and the lowest average occurred in 2015 in the amount of -0,348. While the lowest minimum value occurred in 2016 of -2,698 while the highest maximum value occurred in 2013.

4.1 The Effect of Earnings Volatility on Management's Discretion in Determining the Fair Value of Credit/Financing

The test is done by looking at the significance of the coefficient value of the volatility variable (α1), which is shown in table 2 as follows:

Table 2. The Effect of Earnings Volatility on Management's Discretion in Determining the Fair Value of Credit/Financing

$DAKRDit = \alpha + \alpha 1VOLi + \alpha 2\ LLA\ it + \alpha 3\ SIZE_{it} + \varepsilon_{it}$

Variable	Prediction	Coefisien	t- Stat	Signification	Decision
C		-7,258E+13	-2,914	0,005	
VOL	(+)/(-)	-7,754E+11	-1,899	0.095*	**supported**
LLA		1,0019	13,729	0,000	
SIZE		3,026E	3,480	0,001	
Dependent Variable			DAKRD		
Adjusted R^2			85,3%		
F-Stat			114,983		
Observation			60		

Based on the test results in table 2, the coefficient α1 shows significant results. This means that the profit volatility of Islamic banks affects the discretion of managers in determining the fair value of the credit. These results contradict previous studies [7],[8],[9],[11],[23]. This may be due to the fact that most transactions in Islamic banks are dominated by sale and purchase agreements (mudarabah) so that the margins can be determined. Trust profit sharing (called Mudarabah) and joint venture profit sharing (called Musharakah) are two distinguished and unique products of an Islamic bank [19]. So if the profit volatility is high, the manager will adjust the margin set. Thus, earnings volatility affects the manager's discretion in determining the fair value of credit, is supported.

4.2 The Effect of LLP on the Income Smoothing of Islamic Banks

Testing is done by looking at the significance of the coefficient variable Profit Before Tax (EBT) or β1. The results of testing the second hypothesis are shown in table 3 below:

Table 3. The Effect of LLP on the Smoothing of Islamic Bank Earnings.

$LLP_{it} = \beta + \beta_1\ EBT_{it} + \beta_2 SIZE_{it} + \varepsilon_{it}$

Variable	Prediction	Coefisien	t- Stat	Sigification	Decision
C		-1,615E+12	-2,940	0,005	
EBT	(+)	0,493	2,870	0,003***	**supported**
SIZE		5,911+10	3,125	0,006	
Dependen Variable			LLP		
Adjusted R^2			36,3%		
F-Stat			17,799		
Observation			60		

Table 3 shows that the coefficient on the EBT variable shows a significant positive value. This means that LLP has a positive effect on the income smoothing of Islamic banks. The direction of the positive coefficient can be interpreted that if profit before tax is high then the cost of allowance for losses will be high. This means that increasing LLP is used to flatten profits when there is a surplus of profit sharing to customers [24]. The empirical results show that Islamic banks use loan loss provisions for non-discretionary purposes, but not for discretionary purposes (i.e. capital management, income smoothing, or signaling) [18].

4.3 Effectiveness of the Implementation of Corporate Governance Self-Assessment of Income Smoothing Conducted by Islamic Bank Management

To see the effectiveness of the implementation of corporate governance self-assessment by looking at the significance of the CG * EBT coefficient on LLP (γ3). The test results are shown in tables 4, 5 and.6 below. Table 4 is the results of testing the third hypothesis for the 2011-2016 observation period. The table shows that the coefficient γ3 is insignificant, which means that the effectiveness of the implementation of corporate governance self-assessment will weaken the income smoothing carried out by the management of sharia banks that have not been successfully supported, for the 2011-2016 observation period.

Table 4. Effectiveness of the Implementation of Corporate Governance Self-Assessment of Income Smoothing Carried Out by Islamic Bank Management (2011-2016 Period)

LLP_{it}: γ_1 $EBT_{it} + \gamma_2$ $CG + \gamma_3$ $EBT*SACG_{it} + \varepsilon_{it}$

Variable	Prediction	Coefisien	t- Stat	Signification	Decision
C		-1,473E+12	-2,556	0,013	
EBT		1,094	1,529	0,132	
SACG		-5338	0,997	0,356	
EBT*SACG	(+)	-0,371	-0,916	0,995	**Not Supported**
SIZE		5,436E+10	2,806	0,007	
Adjusted R^2			35,8%		
F-Stat			9,218		
Obervation			60		

Table 5 shows that the coefficient γ3 is significant, which means that the effectiveness of the implementation of corporate governance self-assessment will weaken the income smoothing carried out by the management of sharia-compliant banks for the 2011-2013 observation period.

Table 5. Effectiveness of the Implementation of Corporate Governance Self-Assessment of Income Smoothing Carried Out by Islamic Bank Management (2011-2013 Period)

LLP_{it}: γ_1 $EBT_{it} + \gamma_2$ $CG + \gamma_3$ $EBT*SACG_{it} + \varepsilon_{it}$

Variable	Prediction	Coefisien	t- Stat	Signification	Decision
C		-8,475E+11	-1,517	0,142	
EBT		-3,489	-2,856	0,132	
CG		-2,003E+11	-2,120	0,008	
EBT*SACG	(+)	2,246	3,154	0,004***	**Supported**
SIZE		4,336E+11	2,592	0,016	
Adjusted R^2			67,5%		
F-Stat			16,073		
Observation			30		

Table 6 shows that the coefficient γ3 is significant, which means that the effectiveness of the implementation of corporate governance self-assessment will weaken the income smoothing carried out by the management of sharia-compliant banks for the 2011-2014 observation period.

Table 6. Effectiveness of the Implementation of Corporate Governance Self-Assessment of Income Smoothing Carried Out by Islamic Bank Management (2011-2014 Period)

LLP_{it}: γ_1 $EBT_{it} + \gamma_2$ $CG + \gamma_3$ $EBT*SACG_{it} + \varepsilon_{it}$

Variable	Prediction	Coefisien	t- Stat	Signification	Decision
C		-1,278E+12	-2,358	0,024	
EBT		-2,832	1,772	0,085	
CG		-1,411E+11	0,997	0,165	
EBT*SACG	(+)	1,835	-0,916	0.058*	**Supported**
SIZE		5,496E+10	3,156	0,003	
Adjusted R^2			47,7%		
F-Stat			9,894***		
Observation			40		

From the results of the three tests above for the three periods, it can be concluded that the role of CG in weakening income smoothing was most effective in the 2011-2013 period. In the period 2011-2014 its role declined, and in the period 2011-2016 its role actually did not exist. This requires further research on the effectiveness of the role of SACG in the 2015-2016 period.

To test the difference in earnings volatility before and after the issuance of SE BI no. 15/26 / DPbs, dated July 10, 2013, which requires Islamic banks to use CKPN no later than January 2015. With this regulation, after 2015 the volatility of Islamic banks' earnings is predicted to be higher than in previous years. The results of the different test of the average value of the volatility of Islamic bank earnings between 2012-2013 and 2015-2016 were tested by Paired Samples Test. The test results showed that the average volatility for the 2015-2016 period was 4.841 higher than the average volatility for the 2011-2013 period and the results were significant.

5. Conclusion

This research tested a theoretical framework that examined the impact of the supply chain integration which includes customer integration and internal integration on the organizational performance using the balanced scorecard methodology that related to four aspects of a business: financial, customer, internal processes and organizational capacity, with respect to the Indonesian banking sector. The conclusions that can be drawn from this study are: 1) Earnings volatility affects the discretion of Islamic bank managers in determining the amount of allowance for impairment losses (CKPN) is supported. 2) LLP has a positive effect on income smoothing. This indicates that LLP is used as a way by the management of Islamic banks to smooth income is supported, 3) The mechanism of good corporate governance reflected through self-assessment scores can weaken the income smoothing done by Islamic bank managers.

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