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Sharia Governance and Sustainability Reporting: The Mediating Role of Financial Performance

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Abstract: *Using a sample of registered Sharia Commercial Banks (BUS) in Indonesia during 2014-2017, we examine the effect of Sharia Governance on Sustainability Reporting with financial performance as a mediating variable. Our results support the idea that sharia governance (sharia supervisory board, independent commissioner, board of director's meeting and audit committee) has significant influence on the sustainability reporting. Further analysis indicates the mediating role of financial performance in the relationship between sharia governance and sustainability reporting. Our results suggest that it is essential for regulatory agencies to enhance the supervision role of independent commissioners.*

Keywords: *Financial performance; Sharia Governance; Sustainability Reporting*

Paper type: *Research paper*

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Abstrak: *Menggunakan sampel Bank Umum Syariah (BUS) terdaftar di Indonesia selama 2014-2017, penelitian ini bertujuan untuk mengetahui pengaruh sharia governance terhadap sustainability reporting dengan kinerja keuangan sebagai variabel mediasi. Hasil menunjukkan bahwa sharia governance (dewan pengawas syariah, komisaris independen, rapat dewan direksi dan komite audit) memiliki pengaruh signifikan terhadap pelaporan keberlanjutan. Analisis lebih lanjut menunjukkan peran mediasi kinerja keuangan dalam hubungan antara sharia governance dan sustainability reporting. Implikasi dari penelitian ini yaitu peran regulator sangat penting, sehingga diharapkan mampu untuk meningkatkan peran pengawasan komisaris independen.*

Kata kunci: *Kinerja Keuangan; Sharia Governance; Sustainability Reporting*

INTRODUCTION

The role of Sustainability Reporting is vital for an organization to communicate sustainability performance and its impacts to their stakeholders (e.g., employees, consumers, investors, regulators, suppliers). Based on Global Reporting Initiative sustainability report is a basic report that contains performance, including social, economic and environmental aspects. The study of Ernts & Young in 2015 show that the investor has a limited information due to the insufficient of the quality of corporate sustainability reporting in Indonesia. This lack of information encourages very low transparency of sustainability reports. Furthermore, the study argues that the sustainability report was deemed irrelevant before when it was integrated into the annual financial report. But over time, about three-quarters of the 250 large companies in the world have included "non-financial" information in their annual financial reports based on KPMG’s survey on 2017.

The ultimate goal of the company is not only to maximize the profits and consumer satisfaction, but also to improve the products quality. In other words, the trust of external stakeholders is developed through products, performance and communication. The interests of these stakeholders force companies to carry out activities towards the triple bottom line that includes the economy, society and the environment and performance communication in the form of sustainability reports (Laskar, 2018). By doing it, the sustainability report can help companies to execute their strategies affectively and achieve their ultimate goals.

United Nations (UN) introduce the Sustainability Reporting as an intergral program of their Sustainable Development Goals. This program encourages UN member countries to implement sustainability programs by paying attention to non-financial aspects such as economic, social, and environmental. Hence, the regulatory agencies have started to implement this program by developing the policies to stimulate business entities to undertake social activities and provide sustainability reporting. Islamic bank is a business entity that is provide financial services based on sharia principle. This principle encourages Islamic banks to play a role in mitigating social problems and being socially responsible (Maali, Casson, & Napier, 2006). Sustainability reporting, as a form of corporate non-financial accountability to stakeholders, is aligned with Islamic principles to protect the stakeholders' interests and rights (Iqbal & Mirakhor, 2004).

The Global Reporting Initiative, as a pioneer of sustainability reporting, has triggered the GRI Standard as a reference indicator in disclosure of sustainability reports. However, this standard is only applicable for conventional companies (Haniffa, 2002). To address this limitation, (Haniffa, 2002) develops Islamic Social Reporting (ISR). ISR is a performance reporting standard that is based on the Islamic social reporting index. This index is based on Accouting and Auditing Organizations for Islamic Financial Institutions (AAOIFI) developed by prior researcher. Good corporate governance is one of indicators in both GRI and ISR sustainability reporting standards. According to the regulation, there are principles of corporate governance, e.g., responsibility and transparency.[1] Responsibility reflects the corporate management system that are responsive to the clarity function and business ethics that is carrying out social responsibility. Transparency define that the company is able to provide relevant and material information in easily understandable forms, freely availale, and directly accessible to the stakeholders.

Prior study of (Farook et al, 2011) explores the factors that influence social disclosure in Islamic banks. The results show that political and civil repression, the proportion of Muslim population, Islamic Government Score (IG-Score), Investment Account Holders (IAH) and company size significantly influence the disclosure of corporate social responsibility of Islamic banks. This study includes the sample from Middle Eastern countries such as Bahrain, Kuwait, Saudi Arabia, Turkey, UAE, Qatar and Yaman. Other research also provide evidence on the effect of corporate governance sustainability reporting (Othman & Thani, 2010); (Jo & Harjoto, 2012); (Musibah et al, 2017); and (Mahmood, 2018).

In contrast, using the sample of Sri Lanka firms, the study of (Shamil et al, 2014) provides no significant effect of independent commissioners on the sustainability report. In addition, (Bukair & Rahman, 2015), using the sample of 53 Islamic banks operating in Gulf Cooperation Council (GCC) countries, shows that the directors attributes (board size, board composition, and CEO duality) have no impact on social responsibility disclosure. It may be due to the absence of other important elements of corporate governance. The similar evidence is provided by (Hassan & Harahap, 2010) and (Hashim et al, 2015).

Based on the mixed evidence of the prior research, the researchers have tried to examine the financial performance as a mediating variable. The study of (Jan et al, 2019) shows the significant effect of sharia governance on firm performance. The similar results are also provided by (Badriyah et al, 2015), and

[1] See PP BUMN Minister 2011

(Suteja et al, 2017). Furthermore, (Speziale & Klovienė, 2014) show a significant positive effect between firm performance on sustainability reporting. The existence of a significant positive influence between Islamic corporate governance on firm performance and firm performance on sustainability reportingindicates that firm performance can be used as a mediating variable in the relationship between sharia governance and sustainability reporting.

Sharia governance can be measured from several dimensions. This study uses the sharia supervisory board, independent commissioners, board of directors meetings and audit committee as a proxy to measure the application of sharia governance. The sharia supervisory board (SSB) oversee the implementation of sharia principles such as social and environmental activities which are reported in Sustainability Reporting (Farook & Roman, 2007); (Othman et al, 2009); and (Rahma & Bukair, 2015). The larger size of the SSB is able to increase the breadth of information in sustainability reporting. Therefore we formulate our first hypothesis (H_1a) as SSB has a positive effect on sustainability reporting.

Independent commissioner, as an independent party, serves to ensure that the company are managed on the favor of stakeholders, by providing transparent and accountable information, especially through sustainability reporting. The study of (Muttakin et al, 2015) and (Fauzyyah & Rachmawati, 2018) show that the independent commissioners have a positive effect on CSR disclosure. The greater the size of the Independent commissioner, the more detailed information delivered in sustainability reporting. Therefore, we formulate our second hypothesis (H_1b) as the independent commissioner has a positive effect on sustainability reporting.

Board of directors' meetings reflect coordinating activities of the board of directors related to regulations and management. The study of (Naseem et al, 2017) shows a positive effect of board activity on CSR disclosure. The greater the intensity of the board of director's meeting, the greater the opportunity to convey ideas related to Islamic banking activities, including social and environmental activities, so that more information is disclosed in sustainability reporting. Therefore, we formulate our third hypothesis (H_1c) as the board of directors' meeting has a positive effect on sustainability reporting.

Furthermore, the Audit committee functions as an organ that ensures the company runs in accordance with regulations and standards made. Research on the effect of audit committees on disclosure shows significant positive results (Appuhami & Tashakor, 2016) and (Elhawary & Arafa, 2018). The greater the number of audit committees, the higher the quality of the audit results. Accordingly, we formulate our fourth hypothesis (H_1d) as the size of the audit committee has a positive effect on sustainability reporting.

In addition to corporate governance factors, firm performance is closely related to the realization of sustainability reporting. The study of shows that there is a significant positive effect of firm performance on sustainability reporting. Consistently, the prior studies by (Jan et al, 2019); (Speziale & Klovienė, 2014); (Badriyah et al, 2015); and (Suteja et al, 2017) also provide evidence on the moderating roles of Islamic corporate governance on the relationship between shariah governance and firm performance.

(Nomran et al, 2018) and (Nugraheni, 2018) conclude that SSB has a positive effect on firm performance as measured by ROA. Sharia Supervisory Board (SSB), as mechanism to oversee and provide consideration in sharia aspects, is expected to provide various ideas of sharia banking innovation. This provides an opportunity for customers to get the best option according to their needs, thus finally enhance the Islamic banking performance. The greater the SSB, the higher the financial performance of Islamic banks, so we expect a positive influence of SSB on financial performance (H_2a). Independent commissioners play a function as representatives of minority shareholders and serve as an independent party to evaluate the implementation of the company's strategic policies. The study of (Robin & Amran, 2016) and (Saputra, 2018) shows a positive effect of independent commissioners on financial performance. The greater the size of independent commissioners, the better the supervision so that it is expected to increase financial performance. Therefore, we formulate our H_2b hypothesis as Independent commissioner positively influences financial performance.

The board of directors' meeting reflect the coordination within board of directors. The study of (Al-Daoud et al, 2016) and (Paul, 2017) shows a positive effect of board's meeting on firm performance. The intensity of board's can enhance the quality of coordination and thus speed up the decision making process. The more frequent board's meeting, the higher the opportunity to create new opportunities, so that it is expected to improve financial performance. Therefore, we formulate our H_2c hypothesis as the intensity of the board's meeting has a positive effect on financial performance.

The Audit Committee is mechanism in corporate governance to prevent irregular and fraud activities. The study of (Samout & Nekaa, 2016); (Orjinta & Evelyn, 2018); and (Mohammed, 2018) shows that the audit committee had a positive effect on financial performance. The greater the number of members of the audit committee, may enhance the internal audit quality and thus expectedly to reduce fraud activities and improve financial performance. Therefore, we formulate our H_2d hypothesis that the size of the audit committee influences the financial performance.

The positive significant effect showed by sharia governance on firm performance also firm performance on sustainability reporting based on previous study indicates an existence of mediating role of firm performance in the relationship between sharia governance and sustainability reporting. The existence of sharia governance improve company financial performance through the regulations. In addition, the existence of financial performance can provide firms' incentive to improve the quality of sustainability reporting. This research contribute to the literature by providing evidence of mediating role of financial performance on the relationship between sharia governance and sustainability reporting.

RESEARCH METHODS

Our research focuses on Indonesian Islamic banks during 2014-2017. To obtain our final sample, we use the following criteria: bank is registered in *Financial Service Authority* (OJK); bank provides sustainability and annual reports, and does not engage mergers and acquisitions. We only keep observations with complete financial data.

According to sharia banking statistics published by the *Otoritas Jasa Keuangan* as of June 2019, the number of sharia banks in Indonesia is fourteen, and the total annual report published for in the research is thirteen. The final sample consists of 51 observations, covering 14 banks over 2014-2017.

Table 1. Research Sample

Information	Number
Annual Report or Sustainability Report of Sharia Bank, 2014 - 2017	56
Annual Report is not available	1
Outlier	4
Number of Sample	51

Following (Haniffa, 2002) and (Othman et al, 2009), we use six indicators (adjusted based on AAOIFI guidelines) to measure our dependent variable, the Islamic Sustainability Reporting (ISR). The ISR consists of the following dimensions: 1) Funding and investment; 2) Products and services; 3) Employees; 4) Society); 5) Environment; 6) Corporate governance. We calculate a proxy measure of ISR based on these six different items, each of which is scored as 1 if present and 0 otherwise. An Islamic Sustainability Reporting (ISR) Index is constructed based on the sum of six items divided by six (maximal score).

Our independent variable consists of 1) Sharia supervisory board (SSB) which is measured by the number of SSB in the Islamic bank; 2) Independent Board of Commissioners (In Com), measured by the number of Independent Com in the Islamic bank; 3) Directors' Meeting (BODM), measured by the number of board meetings at the Islamic bank; and 4) Audit Committee (ACom) which measured by the number of Audit Committees at the Islamic bank.

We use return on assets (ROA) to measure financial performance (mediating variable). While previous studies (Suteja et al, 2017) and (Budi et al., 2019) use return on equity (ROE) as mediating variable in the relationship between in corporate governance and ISR, this study uses ROA as alternative of financial performance proxy. Since our initial analysis shows that the results with ROE didn't provide optimum result, we use ROA to provide new contribution in the literature.

To test the hypothesis, whether sharia governance affect sustainability reporting and the role of financial performance as mediating variable, we estimate the following empirical models using ordinary least squares (OLS) regression[2]:

$$\text{ROA} = \alpha + \beta SSB + \beta InCom + \beta BODM + \beta ACom + \varepsilon \quad (1)$$

In the first model, our dependent variable is financial performance measured by return on asset (ROA). We test H_1 using several components of sharia governance. SSB is sharia supervisory board, InCom is independent commissioner, BODM is board of directors' meeting, and ACom is audit committee.

To test H_2, we modify equation (1) as follows:

$$\text{SR} = \alpha + \beta SSB + \beta InCom + \beta ROA + \beta BODM + \beta ACom + \varepsilon \quad (2)$$

In this second model, our dependent variable is sustainability performance (SR). Similar to our first model, we include variables of sharia governance as independent variables and also financial performance measured by return on asset (ROA).

RESULTS AND DISCUSSION

Table 2 reports our regressions results, where we examine the effect of sharia governance on financial performance. The results show that the overall coefficient of SG on ROA p-value of 0.034, which means that it is significant at the 0.05 level. These results indicate that overall Sharia Governance (SSB, InCom, BODM, ACom) variables have a significant effect on Sustainability Reporting. It mean that the better implementation of sharia governance will affect the financial performance of banks. The application of sharia principles in the implementation of sharia bank business encourages Islamic banks to not only focus on profit maximization, but also need to pay attention to social aspects (Maali et al, 2006), so that Islamic banks will avoid exploitative and speculative transactions. This

[2] We also use Sobel test to examine the indirect effect of mediating variable on dependent and independent variable. In unreported tables, several classical assumption tests (e.g., normality, multicollinearity, and heteroskedacity) have been fulfilled to obtain unbiased estimator.

result support the study of (Badriyah et al, 2015), that corporate governance influences firm performance. Furthermore, the adjusted R2 value obtained is 0.128 which means that this model is able to explain at 12.8%, while the rest may be explained by other variables outside the model.

Table 2. Regression Results of Model 1

Variable	B	t	Sig.
ROA = α + βSSB + βInCom + βBODM + βACom + ε			
C	2,388	1,384	,017
SSB	,892	1,892	,064
InCom	-1,015	-1,982	,053
BODM	,010	,382	,703
ACom	,831	2,405	,020
Adjusted R^2		,128	
F		2,845	
Prob (F-statistic)		0,034	

Sources: processed data

Furthermore, Table 2 show that the SSB variable, partially, has a probability value of 0.064, or significant at the 10% level, with a coefficient value of 0.892 and shows a positive direction. This shows that SSB has a significant positive effect on ROA. These results are consistent with the study of (Nomran et al, 2018) and (Nugraheni, 2018). This means that the greater the number of sharia supervisory boards, the greater the opportunity to carry out supervision and monitoring, so as to be able to encourage companies to increase transparency which in turn will increase customer confidence, and ultimately will improve the financial performance of Islamic Banks (Mollah & Zaman, 2015).

Independent commissioner has a probability value of 0.053 or significant at the 10% level, with a coefficient of -1.015, so it can be concluded that the independent commissioner has a significant negative effect on ROA. This result is different from the hypothesis proposed, namely Independent Commissioner has a positive effect on financial performance. However, the results of this study are consistent with the study of (Zulfikar et al, 2017) which found that independent commissioners had a negative effect on firm performance. The difference in results is possible because the independent commissioner does not know in detail and has not carried out its main duties and functions properly as an independent party representing minority shareholders in overseeing, directing and evaluating the implementation of corporate governance and strategic bank policies, so that the role of the independent commissioner has not been carried out well in Indonesian Islamic banking.

The board of director's meeting has a probability value of t is 0.703, the greater singnification level of 0.05, so it can be concluded that the board of director's meeting has no effect on ROA. This result is different from the proposed hypothesis that BDM affects financial performance. However, the result is consistent with the results of (Gómez et al, 2017) and Qadorah (2018) studies, which states that the directors 'activities that are manifested in the directors' meeting do not affect firm performance due to other factors that allow differences in company rules, capital structure, and ownership structure related to corporate governance.

The Audit Committee has a probability value of t of 0.02, or significant at the 5% level, with a positive coefficient of 0.831 which means that the audit committee has a significant positive effect on ROA. These results are consistent with previous studies (Samout & Nekaa, 2016); (Orjinta & Evelyn, 2018); (Mohammed, 2018). Song and Windram (2000) in (Orjinta & Evelyn, 2018) stated the size of the audit committee has capabilities in the field of accounting can encourage companies to conduct supervision and monitoring effectively and efficiently, thereby increasing accountability of financial reporting.

Table 3. Regression Results of Model 2

Variable	**B**	**t**	**Sig.**
SR = α + βSSB + βInCom + βBODM + βAcom + βROA + ε			
C	,693	9,855	,000
SSB	,034	1,778	,082
InCom	-,028	-1,325	,191
BODM	,162	1,254	,216
ACom	-,038	-2,634	,011
ROA	1,550	1,100	,085
Adjusted R^2		,201	
F		3,519	
Prob(F-Statistic)		0,009	

Sources: processed data

Table 3 presents the effect of SG and ROA on SR. Simultaneously these variables have a significant effect with a probability value of 0.009, or significant at the 1% level. The adjusted R2 value obtained is 0.201 which means that the model used in this study can be explained by the variables used by 20.1%, while the rest may be explained by other variables outside the research model. Significant influence indicates the better implementation of sharia governance can encourage companies in the application of existing laws, both positive and Islamic law, so as to increase responsibility for stakeholders, especially by making sustainability reporting. This result is consistent with the study of (Jo & Harjoto, 2012), (Musibah et al, 2017) and (Mahmood, 2018).

SSB variable partially influences SR. This is indicated by the probability value of 0.082, or significant at the 10% level, and a coefficient value of 0.034 which indicates a positive direction, so it can be stated that SSB has a significant positive effect on sustainability reporting. This result is consistent with previous studies of (Farook & Roman, 2007), (Othman et al, 2009), and (Rahma & Bukair, 2015). These results indicate that the number of SSBs that are competent and owned by Islamic banks, are able to increase the accountability that is realized in the making of Sustainability Reporting which contains extensive and detailed information to the stakeholders.

Independent commissioners have a probability value of 0.191, higher than the 5% significance level, so that partially In Com does not affect sustainability reporting. This result is different from the hypothesis proposed that In Com has an effect on sustainability reporting. However, the results of this study are in line with the study of (Listyaningsih et al, 2018) which states that independent commissioners have no effect on Corporate Social Responsibility Disclosure. It is possible because of the lack of competence possessed by independent commissioners, causing supervision and monitoring to be carried out that is not running as it should. Another reason was concluded by (Listyaningsih et al, 2018) which states that the existence of an independent commissioner cannot have a direct influence in decision making because the difference is not directly related to company activities.

The effect of ROA to SR is partially has a probability value at 0.085, or significant at the 10% level, with a beta coefficient of 1.550 and has a positive direction. These results indicate that financial performance (ROA) has a significant positive effect on Sustananility Reporting. The positive direction shows that the higher the financial performance (ROA) the more extensive the information conveyed in Sustainability Reporting. These results are in line with research (Speziale & Klovienė, 2014).

Furthermore BODM has a probability value of 0.216, or more than a 5% significance level, meaning that BODM has no effect on Sustainability Reporting. The results of this study are in line with the research of Dienes, 2018 which states that BMeting Board has no effect on CSR disclosure. This is possible because the information generated in the meeting meeting is irrelevant and not timely according to the needs of the CEO, so the information cannot be used in decision making, even though the nature of board meetings is a means to provide direction and monitoring related to the efficiency and effectiveness of company activities, and encouraging management to improve the quality of information (Barros et al, 2013). The results of this study are in line with the study of (Dienes & Velte, 2016) and (Sunday, Fidelis, & Godwin, 2019).

The Audit Committee has a probability value of 0.011, or significant at the 5% level, with a coefficient of -0.038, or with a negative direction, so the audit committee has a significant negative effect on sustainability reporting. These results are not in accordance with the proposed hypothesis which states that the audit committee has a positive effect on SR. However, these results are consistent with the studiy of (Dilling, 2010) and (Widyasari & Ayunda, 2020) which states that the audit committee as part of corporate governance has a negative effect on the sustainability report. This is possible because there are many audit committees with varying abilities and experience, so that audit decision making takes too long and is less effective (Widyasari & Ayunda, 2020).

Furthermore, to test the existence of ROA mediation on the influence of Shariah Governance (shariah supervisory board, independent commissioner, board of director's meeting and Audit Committee) on sustainability reporting, each variable is tested by path analysis and Sobel test. To determine the significance of mediation or not, it is done by comparing t-counts with t-tables. T-arithmetic is calculated in the following formula:

$$\text{SP2SP3} = \sqrt{p3^2SP2^2 + p2^2Sp3^2 + Sp2^2Sp3^2}$$

t value $\frac{p2\ x\ p3}{Sp2p3}$

Table 4. The Results of Path Analysis and Sobel Test

1.	Variabel	Direct	Sig.	Indirect	t-hitung	Sig.
	SSB to ROA	0.892	Yes	1,389	2,628	Yes
	ROA to SR	1,556	Yes			
2.	**InCom to ROA**	**-1.015**	**Yes**	**-1,580**	**3,131**	**Yes**
	ROA to SR	1,556	Yes			
3.	**BODM to ROA**	**0.010**	**No**	**0,016**	**0,006**	**No**
	ROA to SR	1,556	Yes			
4.	**ACom to ROA**	**0.831**	**Yes**	**1,294**	**3,112**	**Yes**
	ROA to SR	1,556	Yes			
t-tabel: 2,010 (from estimation TINV[0.05_DegreeOfFreedom])						

Sources: processed data

Table 4 shows SSB has an indirect effect of 1.389, thus showing that the indirect coefficient of SSB on SR through ROA is greater than the direct coefficient of SSB on SR (1,389> 0.034). Furthermore, after being tested with the Sobel test, a t-count of 2,628 was obtained, with a significance level of 5%, a t-table of 2,010 was obtained. Therefore it can be concluded that ROA can mediate the influence of SSB on SR (t-count> t-table or 2.628> 2.010). These results are reinforced by the results of the Sobel test (via https://quantpsy.org/Sobel.htm.).

The results of this study are consistent with (Siswanti et al, 2017) which states that firm performance acts as a mediating variable between Islamic Corporate Governance and Sustainability Reporting. The existence of a professional SSB is able to improve the financial performance of Islamic banks, so as to be able to prepare sustainability reporting as a means of accountability and responsibility to stakeholders.

Independent commissioner has an indirect effect of -1,580 and a direct influence of -0,028. Indirect efficiency is greater than direct (1,580> 0.028). After being tested with the Sobel test, it was concluded that ROA can mediate the effect of InCom on SR (t-count 3.131> t-table 2.010). The role of independent commissioners who do not have a direct interest in Islamic banks can optimize the audit and risk management functions (Financial Services Authority Regulation Number 57 /POJK.04/2017). Independent commissioners are able to provide unbiased views so problem solving will tend to be strategic and critical (Robin & Amran, 2016).

The board of director's meeting has an indirect effect of 0.016 and a direct effect on SR of 0.162, so ROA does not mediate BODM to SR (indirect 0.016 <direct 0.162). This is reinforced by the results of the Sobel test, which is a t-count of 0.006 smaller than the t-table of 2010. This can occur because regulations related to the implementation standards and the number of board meetings of each bank differ. Another factor that caused the BODM to not affect the possibility of the presence of the board of directors who did not meet the quorum, so that the results of the meeting decisions lack quality.

The audit committee has an indirect effect of 1,294 and a direct influence of -0,038. These results indicate that the indirect coefficient is greater than the direct coefficient (1,294> 0.378). The Sobel test results show that the t-test value of 3.112 is greater than the t-table of 2.010, so it can be concluded that ROA as a mediating variable is the influence of ACom on SR. The function of the Audit Committee which is under the supervision of the Independent Committee is able to carry out its independent role in auditing activities, thereby increasing the audit quality of Islamic bank financial statements. High audit quality can increase customer confidence, thereby encouraging financial performance, which will ultimately lead to the delivery of information in sustainability reporting.

Overall, sharia governance (sharia supervisory board, independent commissioner and audit committee) influences sustainability reporting with financial performance (ROA) as a mediating variable. These results are consistent with the studies of (Jones, 2007), (Anas, 2014) and (Budi et al, 2019) that there is a significant influence between shariah governance on sustainability reporting with firm performance mediation variables. This indicates that sharia governance that is implemented well, will be able to encourage Islamic banking to be able to carry out operational activities efficiently and effectively. Efficiency and effectiveness of Islamic banking operations will reduce the amount of expense and ultimately will increase profits. High amount of profit will affect the amount of profit sharing that will be given to customers, and the amount of the portion of the budget used to prepare Sustainability Reporting. Extensive and detailed information in Sustainability Reporting will increase customer retention of non-financial activities such as social activities including zakat infaq and shadaqah and the environment (reforestation and financing for go green projects). Submission of this information as a form of accountability of Islamic banking, so that it will increase customer confidence in Islamic banking. This is in accordance with Islamic Stakeholder theory which states that the accountability of Islamic institutions is not only horizontal, but also is vertical (responsibility to Allah swt).

CONCLUSION

This study examines the mediating role of financial performance on the relationship between sharia governance and sustainability reporting. In general, we find that sharia governance (sharia supervisory board, independent commissioner, board of director's meeting and audit committee) positively affect the sustainability reporting. In particular, the sharia supervisory board and the audit committee affect the sustainability reporting, while the Independent Commissioner and the board of directors' meeting insignificantly affect sustainability reporting. Furthermore, the results also provide evidence on the mediating role of financial performance in relationship between sharia governance and sustainability reporting.

This research has an important implications, among others, the substantive role of Independent Commissioners need to be improved, so as to be able to provide a significant role in the management of Islamic banking operations, especially for social and environmental activities. This study subject to several limitations. First, the generalization of the results is limited for coutries that have a similar characteristics as Indonesia. Further examination in countries with different characteristics can provide insights into the effect of institutional setting on role of sharia governance. Second, we only use single measure on the financial performance. Multiple proxies may improve the robustness of the results. Therefore, the further research can employ various financial performance to obtain more robust conclusions. Finally, this study only include limited number of Sharia governance components. Future research could be carried out by including other dimensions such as board gender diversity and board ownership.

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