

Unveiling the Nexus: Audit Quality and Financial Reporting in Sharia Banks—An Analysis of Non-Financial Matrix

Elis Mediawati¹, Mimin Widaningsih², Shahida Shahimi³, Dewi Sarifah Tullah⁴, Indra Pahala⁵, Memen Kustiawan⁶, Hasan Mukhibad⁷

¹Accounting Study Program, Faculty of Economics and Business Education, Universitas Pendidikan Indonesia, Email: elis.mediawati@upi.edu

²Accounting Study Program, Faculty of Economics and Business Education, Universitas Pendidikan Indonesia, Email: mimin.widaningsih@upi.edu

³Research Center for Islamic Economics and Finance (EKONIS), Faculty of Economics and Management, Universiti Kebangsaan Malaysia. email: shahida@ukm.edu.my

⁴Accounting Study Program, Faculty of Business, Institut Bisnis dan Informatika Kesatuan Email: dewisarifah@ibik.ac.id

⁵Bachelor of Accounting, Faculty of Economics, Universitas Negeri Jakarta Email: indrapahala@unj.ac.id

⁶Accounting Study Program, Faculty of Economics and Business Education, Universitas Pendidikan Indonesia. email: memen.kustiawan@upi.edu

⁷Accounting Study Program, Universitas Negeri Semarang, email: hasanmukhibad@mail.unnes.ac.id

Abstract

This research investigates the impact of auditor experience and ethical perspectives on audit quality and financial reporting in Sharia banks in Indonesia. Utilizing a quantitative approach and employing Partial Least Squares Structural Equation Modeling (PLS-SEM), the study reveals a positive and significant relationship between auditor experience and both audit quality and the quality of financial reports. Ethical perspectives of auditors are also found to positively influence these outcomes. The findings highlight the importance of investing in auditor expertise and ethical considerations to ensure the integrity and reliability of financial information in Sharia banks. The study contributes valuable insights for practitioners and policymakers in the Islamic finance sector, emphasizing the crucial role of auditor experience and ethical perspectives in enhancing audit quality and financial reporting in Sharia banks.

Keywords: Auditor Experience, Ethical Perspective, Audit Quality, Financial Report, Sharia Banks.

According to The Indonesian Ministry of National Development Planning, Indonesia aims to become a center of Sharia economics, as

outlined in the "Indonesia Islamic Economic Masterplan 2019-2024". The masterplan envisions Indonesia as "the center of the world's

leading Islamic economy," aiming to create an independent, prosperous, and civilized Indonesia.. Furthermore, Indonesia has accommodated Sharia in its laws, administration, and court system, from independence in 1945 until today (Otto, 2010).

But in Indonesia, Islamic banking is doing better than traditional banking in terms of value, expansion, and development (Hasan, 2023). Notwithstanding their inferior experience, Islamic banks outperformed conventional banks in terms of cost-effectiveness and were able to produce greater income and profit (Viverita, 2010). According to Hasan (n.d.), the study's findings support the positive value of Islamic banking in Indonesia by utilizing data from the Financial Services Authority's Sharia Banking Statistics (Lestari, 2012). A Sharia Banking Development Roadmap 2020–2025 has been released by the OJK to advance Islamic banking in Indonesia. In addition, the country's Islamic banking sector is still expanding at different speeds (Hasan, 2023). In Indonesia, sharia-based financial institutions are emerging, particularly in the fields of Islamic banking and Islamic capital markets (Mediawati & Agustami, 2016).

Research in Sharia banking is interesting for researchers because it is a growing field that offers unique challenges and opportunities. Apart from banking being an interesting topic, refer to (Alifa & Mediawati, 2024). In recent years, its nearly 20 percent annual growth seems to indicate that it is resilient and appealing to a wide range of people, in part because of the principles that govern Islamic financial activities, such as ownership, equity, and participation (Rahman & Hussain, 2012). Researchers have explored various topics in Islamic finance, including the Shariah governance framework, demand for Islamic financial services, and the core topics of the area (Aminul Islam et al., 2011; Ghulamallah et al., 2021; Tijjani et al., 2021). The unique features of Islamic finance, such as the emphasis on risk sharing, limits on excessive risk-taking, and a

strong link to real activities, make it an interesting area of research for scholars (Mubeen et al., 2020).

This research aims to determine the impact of auditors' experience and their ethical perspective on auditing quality and the quality of Islamic bank financial reports in Indonesia. This research is a study that uses two points of view at once, namely Islamic bank employees and auditors. The growing interest in Sharia auditing and financial reporting has opened up new research opportunities in this field making this research important (Rifa'i, 2017). Apart from being a new and growing research opportunity, the role of auditing and financial reporting is also important for Islamic banks. Sharia auditing and financial reporting contribute to better corporate governance practices in Islamic banks.

Literature Review and Hypothesis Development

1. Auditor Experience

The term "auditor experience" can encompass various aspects related to an auditor's knowledge, skills, and practical experience in conducting audits. According to a study conducted by (Barrainkua & Espinosa-Pike, 2018), experience-related differences can influence the content and structure of auditors' knowledge of financial statement errors. Furthermore, according to the American Institute of Certified Public Accountants (AICPA), an experienced auditor is someone who has a reasonable knowledge of audit procedures and generally accepted auditing standards (GAAS).. An experienced auditor also has practical audit experience (AICPA, 2021). Based on these definitions, auditor experience encompasses a broad range of knowledge, skills, and practical competencies related to audit processes, financial reporting, and industry-specific issues, as well as the ability to understand and interpret audit findings based on documented procedures and evidence.

Several studies have investigated the impact of auditor quality. For example, a study found

that auditors' experiences can reduce volatility and bias in earnings reporting and improve auditors' independence (Soroushyar, 2023). Another study found that new auditor reporting requirements are associated with a significant improvement in financial reporting quality (Reid et al., 2019). In the context of Islamic banking institutions, the role of the audit committee and Sharia supervisory board has been examined in relation to financial reporting quality at Islamic banks in Indonesia, highlighting the significance of these oversight bodies in ensuring the integrity of financial reporting (Huda et al., 2020). Research also indicates that auditor experience and competence have a positive influence on audit quality, with auditors' ethics playing a moderating role in this relationship (Ardelean, 2013). The competency of the auditor is identified as an important factor affecting the quality of Sharia audit, particularly in ensuring Sharia compliance and identifying Sharia risk in financial arrangements and transactions (Rashid & Ghazi, 2021). Furthermore, the independence, qualification, and experience of audit and governance committees have been found to impact the internal Shariah audit performance of Islamic banks (Hasnita, 2017). These findings collectively suggest that auditor experience and competence play a crucial role in ensuring the quality of audits and financial reporting in Sharia banks, with the ethical considerations of auditors also influencing this relationship. From this explanation, two related hypotheses can be drawn as follows:

h1: Auditor Experiences have a positive and significant impact on audit quality of Sharia banking institutions in Indonesia

h2: Auditor experiences have a positive and significant impact on the quality of financial report of Sharia banking institutions in Indonesia

2. Ethical Perspective

The ethical perspective of auditors encompasses their obligation to act with honesty and reliability, as well as their impact on public trust and the public interest. Auditors' ethical behavior from personal, age, gender, and culture,

until religiosity. The influence of conscience on auditors' ethical behavior is perceived to be significant. As part of an ethics audit, policies, procedures, and perceptions are evaluated to ascertain whether an organization's vision, mission, and values are consistent (Adekoya et al., 2020; Ardelean, 2013; Barrainkua & Espinosa-Pike, 2018). The ethical content of the audit object is also systematically, independently, and objectively examined and evaluated. Sharia law and ethics (akhlaq) underpin Islamic banking, and all Sharia activities serve as the basis for good faith (aqidah). To keep clients loyal and draw in new ones, Islamic businesses constantly uphold and promote ethics (Alwi et al., 2021). Sharia auditors positively influence Islamic financial products, ensuring their safety and compliance with Sharia laws (Abdullah & Hassan, 2022). Two related theories can be inferred from this explanation in the following ways:

h3: Ethical Perspective has a positive and significant impact on the audit quality of Sharia banking institutions in Indonesia

h4: Ethical Perspective have a positive and significant impact on the quality of financial report of sharia banking institutions in Indonesia

3. Audit Quality

Audit quality is the production of accurate and reliable financial statements (Dresdner & Fischer, 2020). The likelihood that an auditor will find and disclose substantial misstatements in an auditee's accounting system is another definition of audit quality (Tran et al., 2019). The audit quality idea is not restricted to the audit report quality binary model or the audit process quality. It's multifaceted idea on auditor's independence, technical proficiency, and the likelihood of finding and disclosing substantial misstatements (Tran et al., 2019). This multifaceted nature of audit quality underscores the importance of considering multiple drivers of audit quality, such as audit-testing procedures, engagement team personnel, and the decision-making processes within the audit process (Giacomantonio, 2017).

Recent years have seen a significant amount of research on the relationship between audit quality and financial report quality. Empirical data about the connection between financial reporting quality and audit quality has been presented in a number of research. It has been discovered that audit quality proxies, including, have an impact on the caliber of financial reporting (Mohamed Ramadan, 2022). External audit fees and the caliber of financial reporting have been linked to audit committee performance (Rainsbury et al., 2009). This effect may manifest as a large increase in earnings response coefficients, a drop in absolute anomalous accruals, and a tendency to either meet or exceed analyst estimates (Reid et al., 2019). These studies collectively suggest that audit quality has a significant impact on the quality of financial reports, and that various factors, such as audit firm fees, audit firm tenure, and audit committee quality, can influence the reliability of financial statements. From this explanation, a hypothesis can emerge, namely:

h5: Audit quality has a positive and significant impact on the quality of financial reports of sharia banking institutions in Indonesia

4. Quality of Financial Report in The Term of Non-Financial Matrix

The indicators of the quality of financial reports in a Sharia-compliant bank can be assessed through various financial and non-financial metrics. According to a study on bank financial indicators, indicators of risk-taking and risk management, efficiency, profitability, and governance are key predictors of the quality of balance sheets (Nguyen, 2021). Furthermore, non-financial disclosures can also provide insights into the quality of financial reporting. A macro, meso, and microanalysis of non-financial disclosure in the banking industry suggests that the number of quantitative and qualitative indicators in each report can be indicative of the quality of reporting (Cerioni et al., 2021). In summary, the quality of financial reports in a Sharia-compliant bank can be assessed through

indicators such as risk-taking and risk-management, efficiency, profitability, governance, and non-financial disclosures. These indicators provide valuable insights into the overall quality and transparency of financial reporting in Sharia-compliant banks.

5. Conceptual Framework

From several literature reviews conducted and available, a conceptual framework can be built to clarify and guide the implementation of this research.

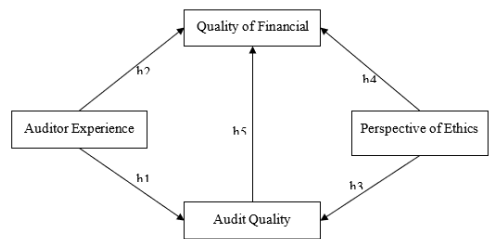


Figure 1. Conceptual Framework
Source: Literature Review, 2024

Methods

1. Research Design

This research was conducted by analyzing non-financial metrics of audit quality and financial report quality using the perspective of auditors. The research uses a quantitative approach to produce objective and generalizable results. The quantitative approach is suitable for this research due to its ability. This approach has been used in various studies related to Islamic finance (Hanif, 2018). The quantitative method allows for the measurement and analysis of performance indicators, which is essential for understanding the impact of auditor experience and ethical perspectives on audit quality and financial reporting in Sharia banks.

2. Sample Size and Sampling Technique

Referring to (Hair et al., 2010), the number of samples suitable for analysis using the PLS SEM method is at least 6 factors. The variables in this research collectively have a total of 14 indicators, which means that the number of

samples taken must be at least 140 people consisting of sharia bank auditors. By considering various possibilities such as errors in filling out the questionnaire, a total of 200 people were decided to be the target sample for this research. This figure represents those who returned the research questionnaire which had previously been distributed to more than 210 people. Purposive sampling technique was considered for use in this research for several reasons. This method explore a specific phenomenon within a well-defined group, such as auditors in Sharia banks. By using purposive sampling, we can ensure the necessary expertise and experience related to the study's objectives, thereby enhancing the relevance and depth of the findings. Some of the sample criteria used are as follows.

1. Auditors have more than 5 years of experience in auditing Islamic bank financial reports.
2. Auditors have attended training and have sufficient knowledge regarding auditor ethics and sharia principles.
3. Auditors are audit personnel who work for audit institutions that have been operating for more than 5 years.
4. Auditors are audit personnel who work for audit institutions that have a good reputation and have never been involved in cases of ethical violations.

3. Data Collection

The survey was carried out using a questionnaire consisting of 14 statement points related to variables. Each statement has answer options that refer to a 5 point Likert scale. By utilizing the online survey platform, namely Google Forms, data collection can be done efficiently and effectively.

4. Data Analysis

Next, the data was analyzed with PLS SEM using SmartPLS version three. PLS-SEM is particularly useful when for predictive analysis and for exploring relationships between latent variables. This method has been used in various studies related to banking, audit quality, and

financial reporting, such as (Baba)(Khan)(Hyarat). Moreover, PLS-SEM has been applied in studies related to Islamic banking, such as (Jarrah). This demonstrates its relevance and applicability to research involving Sharia banks and financial reporting.

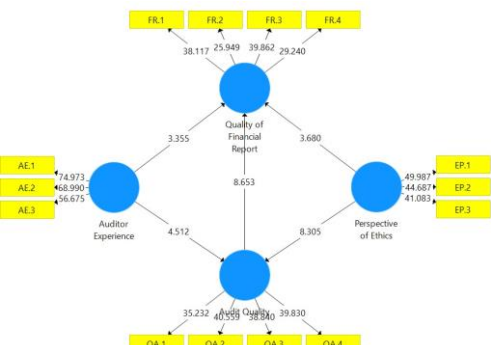


Figure 2. Research Model
Source: Data Analysis Result

Result and Discussion

Result

1. Respondent Demographic

Table 1. Respondent Demographic

Gender	N	%
Male	138	69
Female	62	31
Age (yo)	N	%
18-25	5	2,5
26-35	71	35,5
36-45	69	34,5
46-55	45	22,5
>55	10	5
Years of Experience (Years)	N	%
5-10	68	34
11-15	65	32,5
16-20	40	20
>20	27	13,5
Location	N	%
Java	158	79
Sumatra	23	11,5
Kalimantan	19	9,5

Source: Primary Data, 2023

The table presents a comprehensive demographic overview of a group, delineating characteristics such as gender, age, years of experience, and location. Among the individuals surveyed, 69% identify as male, while 31% are female. Age distribution reveals that the majority falls within the 26-35 (35.5%) and 36-45 (34.5%) age brackets. In terms of professional experience, 34% have 5-10 years, 32.5% have

11-15 years, 20% have 16-20 years, and 13.5% have more than 20 years of experience. Geographically, the majority (79%) are located in Java, with 11.5% in Sumatra and 9.5% in Kalimantan. This comprehensive breakdown provides valuable insights into the composition of the group, facilitating a nuanced understanding of its demographics for informed decision-making.

2. Validity and Reliability of Construct

Table 2. Validity and Reliability Test Result

Variable	Item	Code	Loading Factor
Auditor Experience	CA=0,878 CR=0,925 AVE=0,804		
	1. I possess a deep understanding of Islamic finance principles and practices relevant to Sharia Banks' audits.	AE.1	0,911
	2. I have substantial experience in auditing Sharia Banks, contributing to my better grasp of industry-specific challenges and nuances.	AE.2	0,898
	3. I exhibit a high level of familiarity with Sharia banking regulations, ensuring compliance in my audit processes.	AE.3	0,881
Ethical Perspective	CA=0,814 CR=0,890 AVE=0,729		
	1. I consistently adhere to high ethical standards, ensuring honesty and transparency in all audit-related activities for Sharia Banks.	EP.1	0,876
	2. My ethical perspective emphasizes maintaining independence in thought and action, free from any undue influence, ensuring unbiased audits for Sharia Banks.	EP.2	0,844
	3. I approach audits for Sharia Banks with a commitment to professional objectivity, avoiding conflicts of interest and ensuring impartial assessments.	EP.3	0,840
Audit Quality	CA=0,862 CR=0,906 AVE=0,708		
	1. I ensure that audit procedures conducted in Sharia Banks are thorough and comprehensive, leaving no room for oversight or omission.	AQ.1	0,848
	2. My audits contribute to the accuracy and reliability of financial reporting in Sharia Banks, providing stakeholders with a trustworthy representation of the institution's financial health.	AQ.2	0,818
	3. My audit practices contribute to timely financial reporting, ensuring that stakeholders receive relevant information in a timely manner.	AQ.3	0,845
	4. My audits go beyond mere compliance, providing valuable insights and recommendations that contribute positively to the management and operations of Sharia Banks.	AQ.4	0,853
Quality of Financial Report	CA=0,817 CR=0,878 AVE=0,643		
	1. My efforts in auditing contribute to the accuracy and precision of financial information presented in Sharia Banks' reports.	FR.1	0,837
	2. I ensure that financial reports for Sharia Banks are presented		

<div>with clarity and transparency, facilitating a better understanding for stakeholders.</div> <div>3. I uphold rigorous standards of accounting, ensuring that financial reports align with relevant accounting principles and standards in Sharia Banks.</div> <div>4. The financial reports I contribute to are characterized by the inclusion of relevant and meaningful information for stakeholders in Sharia Banks.</div>	FR.2	0,777
	FR.3	0,813
	FR.4	0,778

Source: Data Analysis Result, 2024

The evaluation presented in the table demonstrates favorable psychometric properties for the assessed variables. Firstly, both Cronbach's Alpha (CA) and Composite Reliability (CR) exceed the recommended threshold of 0.6, indicating robust internal consistency and reliability across all variables, namely Auditor Experience (AE), Ethical Perspective (EP), Audit Quality (AQ), and Quality of Financial Report (FR). Additionally, the Average Variance Extracted (AVE) values surpass the acceptable level of 0.5, signifying satisfactory convergent validity for AE, EP, AQ, and FR. Furthermore, the loading factors for each item within these variables consistently exceed 0.6, highlighting the strong relationships and reliability between the items and their respective constructs. These statements are according to (Hair). In summary, the table suggests that the assessment possesses good internal consistency, reliability, and validity, affirming its suitability for evaluating the specified aspects of auditing, ethical perspective, audit quality, and financial reporting in the context of Sharia Banks.

3. VIF Value

Table 3. VIF Value Test Result

Item	VIF Value	Item	VIF Value
AE.1	2,632	QA.2	1,886
AE.2	2,571	QA.3	2,202
AE.3	2,168	QA.4	2,239
EP.1	1,952	FR.1	2,184
EP.2	1,682	FR.2	2,037
EP.3	1,810	FR.3	1,793
QA.1	1,986	FR.4	1,427

Source: Data Analysis Result, 2023

The table above shows how the VIF Value in this study as a result of existing data analysis shows a VIF Value below 3. According to (Hair's) advice, this value is well considered and shows that the data avoids multicollinearity issues and the data can be used and the analysis can be continued to the next stage.

4. Model Fit

Table 4. Model Fit Test Result

	Saturated Model	Estimated Model
SRMR	0,086	0,086
d_ ULS	0,775	0,775
rms Theta	0,220	

Source: Data Analysis Result, 2024

The provided output pertains to structural equation modeling (SEM) and includes metrics for model fit. The "Saturated Model" represents an idealized model with a perfect fit, serving as a benchmark for comparison with the "Estimated Model," which is the actual structural equation model that has been specified and estimated. Both models exhibit completed analysis, indicating a reasonable fit by measuring the discrepancy between the observed and model-implied covariance matrices. Additionally, the Unweighted Least Squares Discrepancy (d_ ULS) is 0.775 for both models, suggesting consistency in fit assessment. The "rms Theta," a root mean square standardized residual, is 0.220, providing insight into the average magnitude of the standardized residuals. In summary, these fit indices collectively suggest that the Estimated Model reasonably approximates the data, aligning well with the expectations set by the Saturated Model.

5. Coefficient Determination

Table 5. R Square Test Result

	R Square	R Square Adjusted
Audit Quality	0,516	0,511
Quality of Financial Report	0,691	0,686

Source: Data Analysis Result, 2024

The table presents key metrics from a regression analysis, shedding light on the relationship between certain variables. R Square, a measure ranging from 0 to 1, signifies the proportion of variance in the dependent variable explained by independent variables. The corresponding R Square Adjusted considers the impact of predictors on model fit. In the context

of the analysis, "Audit Quality" appears to be a variable associated with the quality of an audit. The R Square value of 0.516 and the adjusted value of 0.511 indicate the extent to which the variance in this variable is accounted for by the independent variables. Conversely, "Quality of Financial Report" is another variable, likely linked to the quality of financial reports. Here, the R Square value is 0.691, with the adjusted value at 0.686, suggesting a relatively higher level of explained variance compared to "Audit Quality." These metrics collectively provide insights into the effectiveness of the regression model in capturing the relationships between the variables under consideration.

6. Hypothesis Test

Direct Effect

Table 6. Direct Effect Analysis

	Original Sample	Sample Mean	STD DEV	T Statistics	P Values
AE->AQ	0,316	0,318	0,070	4,512	0,000
AE->FR	0,170	0,172	0,051	3,355	0,001
EP->AQ	0,511	0,513	0,062	8,305	0,000
EP->FR	0,246	0,249	0,067	3,680	0,000
AQ->FR	0,534	0,531	0,062	8,653	0,000

Source: Data Analysis Result, 2024

The table presents the results of a statistical analysis, likely employing t-tests, to compare the means of different samples. Each row corresponds to a specific comparison between two groups denoted by abbreviations such as AE (presumably representing one group) and AQ (representing another group). For instance, the mean difference between AE and AQ is 0.316, with a standard deviation of 0.070. The t-statistic for this comparison is 4.512, and the associated p-value is 0.000, indicating a statistically

significant difference. Similar interpretations hold for other comparisons, such as AE to FR, EP to AQ, EP to FR, and AQ to FR. In each case, the p-values are less than the conventional threshold of 0.05, signifying that the observed differences in means are unlikely to be due to random chance alone. These results suggest that there are statistically significant distinctions between the groups under consideration, implying potential substantive importance in the context of the studied variables.

Indirect Effect

Table 7. Indirect Effect Analysis

	Original Sample	Sample Mean	STD DEV	T Statistics	P Values
AE->AQ->FR	0,169	0,169	0,044	3,812	0,000
EP->AQ->FR	0,273	0,272	0,044	6,270	0,000

Source: Data Analysis Result, 2024

The presented table outlines the outcomes of a statistical analysis, likely employing t-tests, to compare means across distinct sequences of groups—specifically, AE to AQ to FR, and EP to AQ to FR. In the case of AE->AQ->FR, the mean difference is 0.169 with a standard deviation of 0.044. The calculated t-statistic is 3.812, and the associated p-value is 0.000, signifying a statistically significant difference between the groups. Similarly, for EP->AQ->FR, the mean difference is 0.273 with a standard deviation of 0.044, resulting in a t-statistic of 6.270 and a p-value of 0.000, again indicating a statistically significant distinction. These results imply that the means of the compared groups within each sequence are unlikely to have arisen by random chance alone, suggesting substantive differences between the groups under investigation.

Discussion

1. Influence of Auditor Experience on Audit Quality and Quality of Financial Report

It is possible to conclude that hypotheses 1 and 2 are acceptable based on the data analysis and hypothesis testing results. This indicates that there is a substantial positive association between the quality of Islamic bank financial reports and auditor experience. Hence, increasing the auditor's direct experience is one way to raise the caliber of both audits and financial reporting. The findings of this study are not unique; in fact, they are generally consistent with those of other studies.

A study by (Zahmatkesh and Rezazadeh, 2017) found that auditor experience has a positive impact on audit quality by strengthening the auditor's professional competence, helping them perform the audit better, and giving them the opportunity to acquire more knowledge and sound judgment. The study also discovered a strong correlation between the audit's quality and the auditor's objectivity, responsibility, and professional skills. (Elaoud and Jarboui, 2017) discovered in another study that the quality of an audit is positively impacted by the experience of

the auditor. Another study (Soroushyar, 2023) discovered a positive correlation between the caliber of financial reporting and auditor attributes including tenure and expertise. Another study explored the audit fee which is closely related to audit experiences on audit quality and found a positive impact (Alifa & Mediawati, 2024). However, contradictory findings also exist and make this topic interesting because of the diversity of research results. A study found that auditor size, auditor independence, and auditor industry specialization which is related to auditor experience have a negative effect on earnings management and thus on financial reporting quality.

2. Influence of Ethical Perspective on Audit Quality and Quality of Financial Report

Similar findings can also be seen from the results of the analysis of testing hypotheses 3 and 4, where both are acceptable. Hypothesis 5 which discusses and reports can also be decided to be accepted. This indicates that collectively or partially an ethical perspective can have a positive and significant effect on audit quality and the quality of financial reports. The findings also underline the importance and role of audit quality in mediating the indirect relationship between auditor experience and ethical perspective on the quality of financial reports in Islamic banks. These findings support and are also supported by previous studies.

The ethical perspective of auditors has a significant influence on the quality of financial reports and audits. To ensure that the audit are credible, ethical factors like objectivity, independence, and integrity are essential (Shailer, 2020). Various stakeholders depend on high-quality financial statement audits, and they require people working in the public interest who have the necessary expertise, integrity, independence, professional judgment, and abilities (IFAC, 2022). Auditors bear the obligation of conducting high-quality audits of financial statements, and the ideal conditions for achieving audit quality are those that foster

cooperation and constructive interactions amongst members of the financial reporting supply chain. The values, ethics, and attitudes of auditors, as well as their knowledge, skills, and experience, are crucial factors in achieving audit quality (IAASB, 2014). Therefore, the ethical perspective of auditors is a fundamental aspect that underpins the quality of financial reports and audits.

Implication

The study reveals insights into how auditor experience positively influences audit quality in Sharia banks. This could imply that seasoned auditors possess a deeper understanding of Sharia principles and the unique challenges faced by Islamic financial institutions. Understanding the interplay between auditor experience, ethical perspectives, and audit quality can contribute to more effective risk management in Sharia banks. Compliance with both financial regulations and ethical principles may be crucial for maintaining

the stability and reputation of these institutions. The study contributes to the academic literature by filling gaps in research related to auditing and financial reporting in Sharia banks. Researchers and scholars can build upon these findings for further exploration and refinement of theories in this domain.

Limitations and Future Study Suggestions

It has been underlined that this research only explores the non-financial side of financial reports and audit quality. Further research can be carried out on the financial side so that the results can be more objective and not perceptual. Research can also be directed from the perspective of Islamic bank employees so that the study can be more complex and extensive. Subsequent research can also be carried out more specifically and in-depth, taking a case study on a particular Islamic bank for example, and so on is one way or avenue for subsequent research that can be carried out with more impact.

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