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# CURRENT ISSUES OF ISLAMIC FINANCIAL INSTITUTION SUSTAINABILITY REPORTS

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***Abstract:***
*Indonesia is one of the countries participating in the declaration of Sustainable Development Goals (SDGs) at the UN main office. The achievement of SDGs by sharia financial institutions is supported by government regulations in OJK Regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers and Public Companies. The purpose of writing this article is to find out what issues relate to the reporting of sustainable sharia financial institutions. The research method used is literature study. The results of this research include that sustainability reports are more than just operational performance reports related to ESG but are also strategic assessment tools and communication platforms with investors and other interested parties. Sharia financial institutions should be the driving force for the SDGs. The various standards for preparing sustainability reports have not yet reached optimal standardization. Inconsistent global ESG measurement standards cause investors to be more detailed in making decisions. Sharia financial institutions can easily carry out integration strategies. Financial inclusion and community empowerment can be utilized to achieve the SDGs through Sharia Microfinance Institutions.*

*Keywords: Sustainability Reports, Islamic Financial Institutio*

## Introduction

A total of 193 countries declared the Sustainable Development Goals (SDGs) on September 25, 2015 at the UN Headquarters including Indonesia (Alisjahbana & Murniningtyas, 2018). This declaration was made as a form of state commitment to the global development agenda. The Sustainable Development Goals (SDGs) are a continuation and refinement of the Millennium Development Goals (MDGs) which ended in 2015. On the SDGs website by the Ministry of PPN/Bappenas, it states that the SDGs consist of 17 goals and 169 targets where the direction of sustainable development is based on human rights and equality (Bappenas, 2023). The four pillars of the SDGs in their implementation are social, environmental, economic, and legal and governance and universal principles, integration and inclusion are applied to ensure that no one will be missed or No-one Left Behind.

Indonesia as one of the countries participating in the declaration then issued Presidential Regulation Number 59 of 2017 concerning the Implementation and Achievement of Sustainable Development Goals. This implementation and achievement is carried out until 2030 with the hope that Indonesia will be able to achieve the 17 goals and 169 targets that have been determined in the Indonesian SDGs roadmap. The SDGs roadmap is used as a tool to guide various stakeholders towards achieving the development agenda both from the government and the community (KPPN/Bappenas, 2017). Participation of the business sector is also expected to help create productive collaboration and deep understanding so that the development agenda can be achieved towards Indonesia 2030.

Islamic financial institutions are a business sector that can participate in achieving the SDGs. One real step that can be taken is to apply the principles of environmental, social, and governance (ESG) as a corporate strategy. Audit and Assurance Partner BDO Indonesia, Bambang Budi Tresno said that this step is important to maintain the sustainability of the earth so that the conditions enjoyed today can be felt by future generations in the future (Kompas.com, 2023). By implementing the ESG strategy, the goal of the business sector is no longer just profit but also seeks social and environmental functions so that a balance is created in business. This is actually already in the function of Islamic financial institutions. The application of sharia principles in Islamic financial institutions are already in line with the ESG principles themselves. In fact, Islamic finance should be the main driving force in achieving the SDGs.

Government rules under OJK Regulation Number 51/POJK.03/2017 concerning the Implementation of Sustainable Finance for Financial Services Institutions, Issuers, and Public Companies also assist Islamic financial

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institutions in achieving the SDGs. The actions that financial institutions must take to achieve sustainable financing are governed by these regulations. By taking these actions, Islamic financial institutions are better able to meet the SDG aims (Aldi et al., 2020). One of the steps that has been taken by Islamic financial institutions is the implementation of sustainable finance and banking by PT Bank Syariah Indonesia Tbk (BRIS). The focus of its implementation is on three pillars, namely business refocusing, fixing the fundamentals, and strengthening enablers. These three pillars show that sustainability is part of a single unit in BSI operations by upholding the principle of maintaining a balance between economic growth with environmental sustainability and social welfare for the sustainability of the people (CNBC, 2023). This is also in line with the objectives of sharia or maqashid sharia.

Article 10 of OJK Regulation Number 51/POJK.03/2017 states that financial services institutions are required to prepare sustainability reports (Financial Services Authority Regulation, 2017). This report is prepared separately from the annual report but is an inseparable part of the annual report. The preparation of sustainability reports is an important part for Islamic financial institutions in carrying out their business functions. Although this regulation was issued in 2017, in fact sustainability reports have been required for financial institutions and public companies since 2019 and listed companies since 2020. Due to the Covid-19 pandemic, the implementation was finally postponed to 2021. In the second year of its implementation, 88% of listed companies in Indonesia have submitted sustainability reports in 2022. This issue is important considering that sustainability reports are one of the benchmarks for investors in determining their investments.

## Research methods

The research method used in this article is library research with a descriptive approach. In this study, the author attempts to analyze current issues related to sustainability reports published by Islamic financial institutions. Data collected from books, articles, the internet, and the like that can help the author to analyze the topics discussed.

## Results and Discussion

### Sustainability Report Islamic Financial Institution

In supporting the achievement of SDGs, OJK issued regulations regarding the implementation of sustainable finance for financial services institutions, issuers, and public companies. The regulation states that sustainability reports must be published and are an integral part of the annual report. A sustainability report is a practice of measuring, disclosing, and accountability efforts for the performance of a company/organization in achieving sustainable development goals to stakeholders both internally and externally. Another definition states that a sustainability report is a report based on the concept of sustainable development. Meanwhile, sustainable development means the fulfillment of current development without reducing the needs of future generations to meet their own needs. This report is one of the tools for investors in determining their investments.

*Sustainability report* prepared in accordance with the explanation in the OJK regulations. In 2021, 80% of companies in Indonesia reported based on standards issued by the Global Reporting Initiative (GRI) (PwC, 2023b). The most popular frameworks and standards for creating sustainability reports are the SDGs and GRI. Between 2021 and 2022, the percentage of corporations that disclosed climate-related risks and opportunities in their sustainability reports rose from 77% to 88% (PwC, 2023b).

Sustainability reporting is more than just a report on ESG-related operational performance but also a strategic assessment tool and communication platform with investors and other stakeholders. Sustainability reporting also functions as an annual health check on the company's strengths and weaknesses in continuous improvement to provide beneficial results for the company's business and stakeholders. Sustainability reporting is an important instrument in the ESG reporting approach for companies that reflect strategies in responding to climate risk. In addition to being a form of transparency to the public, sustainability reporting also aligns with global standards and demonstrates the company's commitment to sustainability.

In OJK regulationsNumber 51/POJK.03/2017 explains that sustainability reports must contain at least the following matters (Financial Services Authority Regulation, 2017):

a. Sustainable strategy explanation
b. Overview of sustainability aspects (economic, social and environmental)
c. Brief profile of LJK
d. Directors' Explanation
e. Sustainability governance

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f. Sustainability performance
g. Written verification by an independent party, if any
h. *Feedback*for readers, if any
i. LJK's response to feedback on the previous year's report.

For LJK, issuers and public companies that implement sustainable finance effectively will be given incentives by OJK, the incentives are in the form of including LJK, issuers and public companies in human resource competency development programs, awarding the Sustainable Finance Award and other incentives. In its news page, CNN Indonesia revealed that PT Bank Rakyat Indonesia (Persero) was the only company in Indonesia to win the 2023 Sustainable Finance Awards. In the award event, BRI was named Asia-Pacific Country Winners (CNN, 2023).

In addition to the Sustainable Finance Awards, there are other award events held in Indonesia, including the Deposit Insurance Agency Banking Awards and the Republika Sharia Award. In 2022, the Kontan news site reported that PT Bank Syariah Indonesia TBK (BSI) received three awards, namely the most active bank in CSR activities, the most active bank in improving public financial literacy, and the most active bank in green banking practices. At the 2022 Republika Sharia Award, BSI also received awards in the categories of best mobile banking, best sharia savings, and best sharia bank. For this achievement, BSI is committed to maintaining sharia values and providing healthy and sustainable financing so as to maintain the sustainability of life and the environment. BSI continues to be committed to implementing ESG principles in line with aspects of sustainable finance (Kontan, 2022). Although BSI as a sharia financial institution has not received an award at an international award event, BSI has succeeded in contributing to sustainable development goals.

There are several articles in the journal that discuss sustainability reports and ESG. The first article is entitled "The Effect of Sustainability Reporting Disclosure on Profitability and Its Impact on Company Value" by Nadia Agustin Harfiani from Pasundan University. This article examines ten financial services companies listed on the Indonesia Stock Exchange in 2014-2018. The results show that sustainability report disclosure consisting of economic, social and environmental performance has a significant positive effect on profitability. And profitability has a significant positive effect on company value (Harfiani, 2020).

In another study entitled "The Impact of Sustainability Report Disclosure on Performance: Comparison of Market Performance and Accounting Performance" by Amanda Dwi Kartikasari and Sugiyarti Fatma Laela from the Tazkia Islamic Institute had different results. The results of the study stated that sustainability report disclosure has a positive and significant effect on Earning per share and Return on Equity. While there is no significant effect on Return on Assets (Kartikasari & Laela, 2023). In this study, the sample used was manufacturing companies listed on the Indonesia Stock Exchange in 2018-2022.

Similarly, the research conducted by Tirsa Anisa Wartabone, Nilawaty Yusuf and Nurhayati Panigoro from Gorontalo State University entitled "The Effect of Sustainability Report Disclosure on Company Financial Performance". The results of the study showed that there was no effect of economic and social performance disclosure in sustainability report disclosure on company financial performance. Meanwhile, environmental performance has a significant positive effect on company financial performance. The sample in this study were companies listed on the Indonesian Sharia Stock Index for the period 2018-2021 (Wartabone et al., 2023).

Research conducted by Ithohirah Harahap, Sugianto, and Juliana Nasution from the State Islamic University of North Sumatra entitled "The Effect of Independent Auditor Opinion and Disclosure of Sustainability Reports on Financial Performance with Temporary Syirkah Funds as a Moderating Variable". The research sample was Islamic commercial banks in Indonesia for the period 2016-2021. The results of the study showed that disclosure of sustainability reports had a positive and significant effect on financial performance. And the syirkah fund variable was able to moderate the effect of disclosure of sustainability reports on the company's financial performance (Harahap et al., 2023).

Meanwhile, a study entitled "The Effect of Environment, Social and Governance (ESG) Disclosure on Company Performance" by Gustin Ningwati, Ratna Septiyanti and Neny Desriani from the University of Lampung shows that ESG disclosure has no effect on Return on Equity. The sample in this study were companies listed on the ESG market in 2017-2021 (Ningwati et al., 2022).

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**Current Issues Sustainability Report Sharia Financial Institutions**

a. Islamic Finance as a Driving Force for SDGs

In practice, Islamic finance, which is based on Islamic principles, has in fact adopted the following objectives similar to the SDGs. The 17 objectives and 169 targets of the Sustainable Development objectives (SDGs) are international initiatives to eradicate poverty, lessen inequality, and safeguard the environment. This is equivalent to the spirit and intent of sharia, which coincides with the idea of ESG and SDGs.Since the tenets of Islamic finance closely align with the objectives of the Sustainable Development Goals (SDGs), Islamic finance ought to be the primary engine behind accomplishing the SDGs (Aldi et al., 2020). Profit sharing, staying away from usury, staying away from speculative companies, and having the actual sector support every transaction are some of these concepts.

One of the global options for reaching the Sustainable Development Goals (SDGs) objectives established by the United Nations (UN) is Islamic financing. In addition to addressing poverty, Islamic finance also addresses gender equality, infrastructure development, health improvement, and high-quality education. covers lowering income inequality, forecasts of climate change, and economic development. The creation of an Islamic financial system is crucial for accomplishing the SDGs since some Islamic financial tenets promote economic equality and emphasise social and environmental initiatives.
(Dewi et al., 2023).

As the authority of the Indonesian financial services sector, OJK continues to encourage the development of the sharia financial sector, starting from sharia banking, sharia non-bank financial institutions, to sharia capital markets. There are many instruments in the sharia financial system, both banking and non-bank financial institutions, that can be used to achieve the SDGs. Sharia microfinance institutions are also a relevant means to achieve the SDGs through the realization of sharia economic contributions. The role of sharia microfinance institutions in achieving the SDGs is greatly needed, especially because of its impact on society. The role of sharia microfinance institutions in achieving the SDGs is to provide business financing to small and medium groups and improve the economic level of the entire community (Soemitra, 2018). Second, access to quality services, including the provision of investment products, to all parties who want to access financial products. Sharia microfinance institutions must understand and apply this form of investment to the entire community to generate additional income and increase economic income.

b. Standardization of Sustainability Report

Currently, international standards on sustainability reporting are still very diverse. Efforts are ongoing. For reach standardization in report sustainability. There is five sustainability standards *reporting* namely the International Integrated Reporting Council (IIRC), Sustainability Accounting Standards Board (SASB), Climate Disclosure Standards Board (CDSB), Global Reporting Initiative (GRI), and Carbon Disclosure Project (CDP). The five standards agreed to work together to form a comprehensive corporate reporting system.

The development of IFRS Sustainability Disclosure Standards (sustainability disclosure), has a close relationship with IFRS Accounting Standards (financial reporting). These standards are being developed much faster than IFRS accounting standards. The most popular frameworks and standards are the SDGs and GRI. Most nations utilise it extensively for sustainability reporting, with TCFD and the International Organisation for Standardisation (ISO) coming in second and third. Eighty percent of Indonesian enterprises polled in 2021 said they were adopting the GRI Standards (PwC, 2023b). With the recent introduction of the TCFD Framework architecture-based International Financial Reporting Standards (IFRS) Sustainability Disclosure Standards S1 and S2, it is anticipated that firms would embrace climate-related disclosures more and more. The IFRS Sustainability Disclosure Standards grant early adopters an exemption during the first year of IFRS S1 and S2 implementation, enabling them to apply IFRS S2 Climate-related Disclosures first. In the second reporting year, they can then apply IFRS S1 General Requirements for Sustainability-Related Disclosures of Financial Information. Standard publication IFRS sustainability disclosures are expected by the end of the second quarter of 2023, and the implementation obligations of these standards will be determined by the authorities in each jurisdiction.

*IFRS Sustainability Disclosure Standards*focuses on disclosures that are likely to be presented in the Notes to the Financial Statements (CALK) in the Annual Report or if referring to SEOJK Number 16/SEOJK.04/2021, the Sustainability Report is part of the Annual Report but can be presented separately. Attachment II of SEOJK 16/2021 explains that the preparation of sustainability reports can be expanded as needed, including by referring to international standards. This new standard is also likely to be applied by several sectors because it adopts one of the international standards, namely SASB, where this standard usually identifies sustainability issues for 77 industries.

The implementation of this new standard is one of the climate change mitigation efforts to support the 2050 zero carbon emission commitment. Where Indonesia is one of the countries that contributes to reducing emissions according to the Paris Agreement as a form of climate change control. With the new standard being developed by the IFRS Foundation through the ISSB, investors are expected to consider companies that use the new standard before deciding to invest. Thus, the number of companies that make sustainability reports can increase along with the needs of investors.

c. ESG Performance Measurement

Companies with good ESG practices tend to face lower long-term risks.

ESG performance measurement helps identify potential risk factors such as environmental issues and regulatory non-compliance. This allows investors to reduce volatility in their portfolios. Quoted from the esgindonesia.com website, ESG performance measurement in an investment portfolio is as follows (Hanggoro, 2023):

1) Environmental Factors

   ESG performance measurement on environmental factors involves evaluating a company's carbon footprint. Investors will assess how the company's efforts are in reducing carbon emissions and utilizing renewable energy. Investors also consider the company's management of natural resources. Efficient use of resources and waste management policies are key to determining investor decisions.

2) Social Factors

   In social factors, employee welfare is important. This relates to the company's policy on labor rights, welfare programs and inclusiveness. Positive values in ESG indicate that the company pays special attention to employee welfare. In addition, community involvement in the company is also a concern. Contribution companies towards local communities, social responsibility, and support for the community are part of ESG performance measurement.

3) Governance Factors

   ESG performance measures include evaluating a company's reporting policies, board structure, and regulatory compliance. Transparency and accountability in governance practices provide investors with confidence in the company's integrity and business sustainability. The strategic business capabilities of leaders are also important factors. Companies with strong leadership are more likely to be able to face challenges and adapt.
   to change.

Global ESG performance measurement standards are not yet consistent. Each company has different evaluation criteria, so investors need to understand more deeply the consequences of diversity in measurement methods. Companies also provide less detailed data. As a result, the data received by investors is very limited. In addition, because the dynamics of different industries make investors more critical in assessing ESG performance. This is related to the different criteria of each industry.

*Sustainability Analytics*One of the world's ESG research organizations conducts ESG risk assessments using the concept of risk decomposition, namely two dimensions of ESG issues in the form of exposure and management. Exposure is a material ESG risk faced by the company and affects the ESG risk assessment. While management is a company's commitment or real action in dealing with ESG issues by determining various policies and work programs (Idx.co.id, 2023).

d. Integration of ESG with Sharia Business Strategy

The UN defines responsible investing as an investment strategy that specifically takes into account environmental, social, and governance (ESG) considerations in addition to the long-term stability and health of the market overall. ESG objectives are consistent with the implementation of maqashid sharia in Islamic financial institutions such as Islamic banks. Islamic banking can be superior in implementing ESG principles because it has fundamental values that are in line with each other. According to an observer of Islamic Economics at the Faculty of Economics and Business, University of Indonesia, Fauziah Rizki Yuniarti, Islamic banking can excel in ESG and SDGs values because it has many cheap funding sources. For example, those

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originating from Islamic social funds such as zakat and waqf, even free funding sources from waqf (Puspaningtyas & Alamsyah, 2022).

Because the principles between ESG and Islamic financial institutions are aligned, it makes integrating ESG with business strategy easier. The business strategy implemented by Islamic financial institutions is already directed towards the ESG principle itself. Integrating ESG into business strategy, risk management processes, and performance measurement through better reporting can save costs, generate long-term value creation, and provide information for investment decisions related to technology, workforce, planning, supply chain, and asset acquisition and divestment, etc. Islamic financial institutions can take three steps to improve integration. The first is designing an ESG governance structure, including ESG reporting. Second, aligning ESG KPIs with executive and management incentives. Finally, planning and providing a training curriculum to improve skills and develop self-sufficiency (PwC, 2023a).

It is important for Islamic financial institutions to understand the expectations of key stakeholders and take practical actions to address their needs and concerns in a timely manner. Currently, investors no longer consider things that are not ESG-friendly as externalities outside of investment that can be compensated for with Corporate Social Responsibility/CSR. With this awareness, CSR is more likely to be considered as a superficial social legitimacy so that investors want to invest their funds in companies that internally accommodate ESG values because investments are no longer considered value-free (Rakhmawati, 2021). This includes embedding sustainability considerations in business strategies and balancing business, environmental, and societal impacts. This will support more precise alignment and clarity in conveying the company's sustainability narrative.

ESG integration has a significant impact on business continuity. Through this holistic approach, businesses can manage risks, capitalize on opportunities, build a strong reputation, and gain an edge.
competitive in an increasingly ESG-conscious market (CRMS, 2023). It is important for companies to prioritize the integration of ESG and GRC in their business strategies to ensure sustainability and growth in the future.

e. Financial Inclusion and Community Economic Empowerment in Realizing SDGs

Financial inclusion and economic empowerment are two concepts that are interrelated and have great potential to transform people's lives. In some countries, many people do not have access to formal financial services such as bank accounts, loans and insurance. This limited access hinders economic growth, reduces employment opportunities and exacerbates social inequalities. However, through the right financial inclusion initiatives, people can be economically empowered, improve their well-being and contribute to sustainable development (Wepo, 2023).

Financial inclusion plays an important role in reducing poverty, increasing economic growth, and strengthening the financial resilience of the community. The Director of Financial Services Institution Supervision of the Financial Services Authority (OJK) Regional 8 Bali and Nusa Tenggara, Dr. Nasirwan said that there are at least two important things that Islamic financial institutions have related to financial inclusion. First, the business model and service products of Islamic financial institutions that are not owned by conventional financial institutions. The second thing that is an important contribution of the Islamic financial system related to financial inclusion is the existence of instruments that are inherent in Islamic economics, namely zakat, infaq, sedekah, and waqf (Unpad, 2023).

According to Andri Soemitra in his book The Role of Community Empowerment by Islamic Microfinance Institutions in the Perspective of Sustainable Development Goals (SDGs), states that community empowerment through Islamic Microfinance Institution activities is one form of treatment carried out on the community in order to drive the wheels of the economy. Islamic microfinance institutions in the form of Islamic cooperatives and Baitul Mal Wat Tamwil play an important role as financial intermediary institutions that specifically touch the lower class community who have difficulty penetrating capital access due to the difficulty of penetrating the criteria and requirements for disbursing financing in commercial banking (Soemitra, 2018).

## Conclusions and Suggestions

From the explanation above, several conclusions can be drawn. First, the sustainability report is an additional report that is no less important than the annual report. The sustainability report is more than just an operational performance report related to ESG but also a strategic assessment tool and communication platform with investors and other stakeholders. The sustainability report is an important instrument in the ESG reporting approach for companies that reflect strategies in responding to climate risk. Second, Islamic financial institutions that carry out Islamic financial operations should be able to be the driving force in sustainable development goals or SDGs. This is because the principles in Islamic finance overlap with the principles in SDGs and ESG. Third, the various standards for preparing sustainability reports have not yet achieved optimal standardization. With the IFRS Sustainability Disclosure Standard, it can produce standards that are stated in PSAK in accordance with OJK Regulation Number 51/POJK.03/2017 and OJK Circular Letter Number 16/SEOJK.04/2021. Fourth, the inconsistent global ESG measurement standards require investors to be more detailed in determining investment decisions. Fifth, integrating ESG into business strategy, risk management processes, and performance measurement through better reporting can save costs, generate long-term value creation, and provide information for investment decisions related to technology, workforce, planning, supply chain, and asset acquisition and divestment, etc. Islamic financial institutions that share the same principles as SDGs and ESG can easily integrate. Finally, financial inclusion and community empowerment can be utilized to achieve SDGs through Islamic Microfinance Institutions. This is because these institutions can reach the lowest levels of society. In addition, there needs to be a deep focus on the implementation of Islamic microfinance institutions in guiding the community so that they can eradicate poverty.

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