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Modification Finance of Salam and the Implications for Salam Accounting Treatment in Indonesia

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Abstract

Bank Indonesia has set standardization of *Salam* and PSAK No. 103. The theoretical study results showed that the non-application of *Salam* contract in the Islamic Banking includes: fear of the banks on dishonesty or farmers' harvest failure, the risks that brought by *Salam* contract and the lack of socialization of *Salam* contract to the farmers. The modified solutions made to eliminate the problem at *Salam* contract is to establish agricultural banks, providing socialization and education to farmers, giving option to the payment system of *Salam* and the amount of farmers' credit are not the basic price of farmers' harvest.

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1. Introduction

Islamic banks development is growing fast and it should be going along with the development of product types and contract variations which is in accordance with Islamic principles. Based on data from Statistics Islamic Banking (Bank Indonesia, 2012) stated that the number of Islamic Banks in 2006 amounted to 3 (three) bank with 349 offices. Meanwhile, until the end of 2012 the number of Islamic banks significantly increases and reaches 11 banks with 1745 offices. It shows that the growth of Islamic banks in Indonesia is quite rapid. According to a survey that has been

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conducted and reported in Global Islamic Finance Report (CIMB Islamic, 2012) Indonesia ranked the seventh in the development of Islamic banking in the world (Wardayati and Wulandari, 2014).

Product development is expected to meet the needs of customer transactions. One of the important issues faced by Islamic banking is the problem of financing products variation that are still dominated by *Murabaha*, *Musharaka* and *Mudaraba* which can be seen in the Table 1. Though there is still variety of other contracts that could be implemented.

Table 1. Composition of Islamic Banking Financing based on Contract (On Billion Rupiah)

Contract	2008	2010	2012	2014
Contract of Mudharabah	6.205	8.631	12.023	14.354
Contract of Musyarakah	7.411	14.624	27.667	49.387
Contract of Murabahah	22.486	37.508	88.004	117.371
Contract of Salam	-	-	-	-
Contract of Istishna	369	347	376	633
Contract of Ijarah	765	2.341	7.345	11.620
Contract of Qardh	959	4.731	12.090	5.965

Source obtained and processed from: *Islamic Banking Statistics Data 2008-2014*

From the data above, *trend* in the *Salam* financing agreement in Islamic banking does not exist at all. Whereas, the purchase of *Salam* contract with down payment is quite *applicable* for one of banking products, especially in the agricultural sector. With the existence of inequality, which according to the draft of *Salam contract* but is not applied in the agricultural sector, making the author interested in conducting the research on how to build solutions to make the contract of *Salam* as one of the *applicable* financing products to be applied in the Islamic banking industry.

2. Literature Review

2.1 Definition Financing of Salam

PSAK 103 explains that *Salam* is a contract of sale and purchase of goods' orders (*muslam fih*) with the delivery on later dates by the seller (*muslam illaihi*) and the repayment made by the buyer at the time the contract was agreed in accordance with certain conditions. The explanation of article 3 of Bank Indonesia Regulation No. 9/19 / PBI / 2007 regarding the principles implementation of Islamic banks in the activities of fund collection and distribution of funds and services for Islamic banks mentioned the definition of *Salam* as" the buying and selling of goods by way of reservations with certain conditions and the advanced case payment is paid in full." According to Muhammad Shafi Antonoi (2002: 108) *Bai 'as-Salam* means the purchase of goods delivered in the later days, while the payment is made in advance. So that, *Salam* is a transaction which the delivery of ordered good is deferred while the payment is paid in cash at the beginning of the transaction by obtaining certain conditions.

2.2 Characteristics of Salam

Characteristics of *Salam* include: specifications and price of goods (agreed in the initial contract) with the following provisions: (1) The price of goods cannot be changed during the term of the contract, and (2) Bank as buyer-where banks can request a guarantee to avoid the risk of harm. Ordered goods agreed between the seller and the buyer with the following provisions: (1) The general characteristics should be noted such as type, kind, quality, and quantity of the goods, and (2) The seller must be responsible when the goods sent do not meet the characteristics previously noted.

Provisions concerning the payment of *Salam* are: (1) the amount and form of payment tools should be known, either in the form of goods, money or benefits, (2) Payment must be made when the contract agreed upon, and (3) Payment may not be in the form of debt relief. Provision of goods, i.e.: the characteristics should be clear and can be recognized as debt, explaining the specifications, the delivery is done at the later days, the time and place of goods delivery have

to be set based on the agreement, the buyer should not sell the goods before receiving, and the goods should not be changed, except with similar goods as agreed.

2.3 Pillars and Terms of Bai 'As-Salam:

Pillars of Bai 'As-Salam include: *Muslam* (Buyer), *Muslam ilaih* (seller's), capital or money, *Muslam fiih* (goods), and *sighat* or utterance. Whereas the Terms of Bai 'As-Salam is: (a) Relating to the capital transaction of bai' as-Salam, the capital transactions must be known and in the form of cash and the payment of *Salam* should be done in the contract, and (b) In relation with the goods, the goods should be specific and can be recognized as debt, should be identified clearly, most scholars requires the delivery of goods is done in the future, but Shafi'i allows immediate delivery of the goods, it is allowed to determine the date for goods delivery in the future, the place for delivery has to be agreed by both parties, and it is not allowed to change the goods with different things. But if the goods are replaced with other items that have the same specifications and quality, it is permissible.

2.4 Parallel Bai 'As-Salam

Salam, in Islamic banking technical means purchases made by a bank with a upfront payment to the first party (Customer I) and is sold again to another party (the customer II) with an agreed delivery period. Capital / price paid in *Salam* should not be in the form of debt, but in the form of cash which is paid immediately.

2.5 Financing applications of Bai 'Al-Salam in Islamic Banking Indonesia

Application of *Salam* contract for banking takes the bank as buyer, while the customer as a seller. When the goods have been delivered to the bank, then the bank will sell them to the customers by cash or installments. The purchase price of bank is the price plus the profit (Muhammad, 2005). *Bai' Al- Salam*, usually used in financing for farmers with a relatively short period of time, i.e. 2 to 6 months. Because the goods purchased by the bank are such as rice, corn , and chili and are not intended to make such items as deposits or inventory, then second *Bai' Al- Salam* contract is done, for instance to *Bulog*, the market traders and wholesalers. This is what is known in Islamic banking as Parallel *Salam* (Antonio, 1999) .

Based on a compilation of SOP submitted by Islamic banks, stages of *Salam* and Parallel *Salam*'s implementation shown in Table 2 below.

Table 2. Stages Summary of *Salam* contract and Parallel *Salam* According to one of Islamic Banks' SOP

No	Stages
1	The demand for certain goods with clear specification by Islamic bank customers as the buyer to the seller
2	<i>Wa'ad</i> customers to buy goods at price and time resilient delivery of goods as agreed
3	Looking for producers that are able to provide the goods needed (according to the agreed time limit with a lower price)
4	Banding one between banks as the seller and the customer as a buyer to buy goods with certain specifications which will be delivered at predetermined time
5	The payment made at the beginning of the contract and the remaining payment is set before the goods are received or it is agreed to be paid in instalment.
6	Binding two between banks as buyers and customers as producer the seller to buy goods with certain specifications that will be delivered at predetermined time
7	Payments are made immediately by the bank as the buyer to producer customers at the time the binding is done
8	Delivery of goods is done directly by the producer customers to buyer customer at a specified time

Source: Buchari, et al, 2005 in Ascarya 2006

2.6 Accounting Treatment (PSAK 103)

Salam accounting treatment in Indonesia is based on PSAK 103 which explains:

A. Accounting For Buyers

1. Receivables *Salam* recognized when *Salam* capital is paid or shifted to the seller.
2. Venture capital of *Salam* can be in form of cash and non-cash assets. Venture capital *Salam* in the form of cash is measured at the amount paid, whereas venture capital of *Salam* in the form of non-cash assets is measured at fair value. The difference between the fair value and the carrying value of capital non-cash handed is recognized as profit or loss upon the delivery of the venture capital.
3. Reception of the ordered items is recognized and measured as follows:
 - (a) If the ordered goods suited the contract, then assessed according to the agreed value;
 - (b) If the ordered goods are different in quality, then:
 - (i) Received ordered goods are measured in accordance with the contract value, whether the fair value of received ordered goods is equal or higher than the value of high ordered goods value in the contract;
 - (ii) Ordered goods received are measured according to the fair value at the time it is accepted and the difference is recognized as loss, if the fair value of received ordered goods is lower than the value of ordered goods listed in the contract;
 - (c) if the buyer does not receive some or all the ordered goods on the due date, then: (1) if the delivery date is extended, then the carrying value noted as receivables of *Salam* for parts that have not been fulfilled in accordance with the value stated in the contract; (2) if *Salam* contract is cancelled partially or entirely, then *Salam* credits turned into accounts receivable that must be paid by the seller for the part that cannot be met; and (3) if *Salam* contract is cancelled partially or entirely and buyers have the guarantee of ordered goods and the sale results of the guarantee is less than *Salam* receivable value, then the difference between the carrying value is taken as *Salam* receivables and the outcome of sales recognized as credit to the seller. On the contrary, If the outcome of the collateral is higher than the carrying value taken as *Salam* receivables, so the difference is the right of seller.
4. Fines received by the buyer are recognized as part of the charity fund.
5. Buyers could impose fine to the seller, fining should only be charged to the seller who is able to settle its obligations, but deliberately did not make it. It is not applied to sellers who were not able to fulfil its obligations due to force majeure.
6. Fines imposed if the seller fails in performing its obligations in accordance with the contract, and the fines received are recognized as part of the charity fund.
7. Received ordered goods are recognized as inventory. At the end of the financial reporting period, inventories acquired through *Salam* transaction is measured at the lower of cost or net realizable value. If the net value that can be realized is lower than the cost of receiving, the difference is recognized as loss.

B. Accounting For Sellers

1. The duty of *Salam* recognized when seller received *Salam* capital as much as received *Salam* capital.
2. Received *Salam* capital can be in form of cash and non-cash assets. Cash *Salam* capital is measured by the amount received, whereas non-cash *Salam* capital is measured at fair value.
3. The obligation *Salam* derecognized on the delivery of goods to the buyer. If sellers do parallel *Salam* transaction, the difference between the amount paid by the buyer end and the received cost of ordered goods recognized as profit or loss when the delivery of ordered goods by the seller to the buyer ends.

3. Research Method

The approach used in this research is qualitative approach. The study design used is descriptive qualitative. Qualitative descriptive approach is to explain what the problems are, solutions in *Salam* financing and effects on *Salam* accounting. Data used in this research is description of written documents. Data were collected from various sources including scientific journals, relevant researches, appropriate books, articles and SAK. So the data collection techniques used is the analysis of documentary studies.

4. Result

4.1 Salam Financing Modification And Its Implication For Salam Accounting Treatment

Based on the results of the literature reviews, then the problem of the non-implementation of a *Salam* contract in Islamic banking include;

1. Fear of the banks on dishonesty or farmers' harvest failure (Roziq, 2014. Affandi, 2014. Abrista, 2009). Operational problems that might be encountered in *Salam* financing is the difficulty in giving understanding to prospective customers about *Salam* financing, and supervise farmers to maintain the quality and quantity of harvest. (Roziq, 2014).
2. The risks that brought by *Salam* contract is high (Roziq, 2014. Affandi, 2014. Abrista, 2009, Ashari, 2005, Adi, 2012). *The Contract Of Salam* is risky to seasonal agriculture, for instance bad weather or pests, the great cost and profit are not comparable, the goods ordered when due date is not completed or the quality is not good. Storage or warehouse should be owned, the price cannot be determined after harvest, the waiting time and crops do not meet the expectations (Affandi, 2014).
3. The lack of socialization of *Salam* contract to the farmers (Roziq, 2014, affandi, 2014., Abrista, 2009). The absence about *Salam* contract information, knowing only the financing or seasonal financing instalments, the bank does not give any explanation, explaining only the financing instalments or seasonal (Affandi, 2014)

By these problems, building solution to make the contract of *Salam* as one of the *applicable* financing products in the Islamic banking industry is needed. The modifications that are expected to eliminate problems of *Salam* contract are;

1. Establishing agricultural banks. By establishing agricultural bank the contract of *Salam* can be applied as one of financing models for agriculture. According to the expert, they found the need to establish agricultural banks has transition. That is, the agricultural bank is not immediately established as a form of bank whose legal aspect should meet the requirements of banking law. However, the agricultural bank can be formed through BUMD institutions. This strategy is also a priority based on the data collected among experts and practitioners. (Abrista, 2009; Antonio, 1999 on Wasilah, 2011).
2. Providing socialization and education to farmers. Through outreach programs, education and good communications done to customers both generally for the farmers and customers in particular. This program is not only performed by banks but also done by the External such as academics, and so on (Abrista, 2009; Roziq, 2014).
3. *Salam* contract Ssystem with the option of payment whether in cash or instalments system. *Salam* system financing models from farmers with parallel *Salam*, then the financial institution of sharia (Islamic Bank, Islamic rural banks and cooperatives Sharia) will get benefits from margin or price mark up. Payment system such as *istisna* is done instalments or *murabaha* (Roziq, 2014).
4. The amount of farmers' credit is not the basic price of farmers' harvest. To minimize the losses banks due to the risk of crop failure, the amount of receivables is not as the magnitude of the bank's purchase price, but as the down payment. The cost is determined after note taken with the services of appraiser or in cooperates with the department of agriculture, considering one of the tasks of the agriculture department is formulate operational policies, guidance, regulation and business of facilitation development, processing and marketing of agricultural products, or other ways to launch this transaction. And according to the writer, the farmers will not mind, as long as the magnitude of receivables is in accordance with the quality of goods.

The solutions built in modifying *Salam* contract, the implications from the accounting treatment of *Salam* are; Accounting for buyer; the recognition of receivables are recognized when it is paid to the seller, but the amount of receivables is not as the basis for the amount bank's purchase price, but as an down payment. The cost is determined after knowing to the farmer's crops.

5. Conclusion

The results of this theoretical overview shows that the problems of the non-implementation of *Salam* contract in Islamic banking are; (1) the fear of the banks on dishonesty or farmers' harvest failure (2) the *Salam* contract is risky (3) The lack of the socialization of *Salam* contract to the farmers. By these problems, building solutions to make the contract of *Salam* as one of applicable financing products is needed to be applied in the Islamic banking industry. The need for building solution to make the contract of *Salam* as one of the *applicable financing products* applied in the Islamic banking industry.

The problems of *Salam* are expected to be eliminated by doing modification such as; (1) Establishing agricultural bank; (2) Providing socialization and education to farmers; (3) giving option to the payment system of *Salam* by cash or installment; (4) The amount of farmers' credit are not the basic price of farmers' harvest. By the solutions made to modify the contract of *Salam*, then the implications toward accounting are; accounting for buyers; the credit of *Salam* is admitted when the capital is paid to the seller. The amount of credits is not taken as the purchase price of the bank, but as down payment. The cost is determined after knowing to the farmer's crops.

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