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Earnings Management in Prophetic Accountability Review

[1]Waris Mappiare, [2]Sumarlin, [3]Muhammad Wahyuddin Abdullah

[1]University of Muhammadiyah Makassar

[2]Alauddin State Islamic University Makassar

[3]State Islamic University of Alauddin Makassar

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Abstract: Earnings management in this study is based on Schipper's opinion which states that earnings management is management engineering carried out by management to deliberately intervene in the process of determining earnings or financial reporting by utilising accounting techniques and policies for specific purposes. This study aims to examine and analyse the perspective of prophetic values on earnings management practices. This study uses a qualitative descriptive method, data collection techniques and literature studies. The results showed that basically earnings management can be in accordance with Islamic values and principles. The company management should be responsible for maintaining the accountability of a company or organisation, so that no stakeholders are harmed by the existence of the organisation or company. Accountability is a reference to the implementation of the accounting process and the results of financial statements that describe the company's actual financial condition. Prophetic accountability is an important pillar driving civilisation towards essence.

Keywords: Earnings management, Prophetic accountability

I. Introduction

Statement of Financial Accounting Concept *(SFAC)* No.1 states that the main purpose of financial statements is to provide information, especially of a financial nature for interested parties in the context of making economic decisions. In the perspective of *agency theory,* financial statements are the main means to account for what management as agents have done with the resources of shareholders as principals. Broadly speaking, public companies whose share ownership is in the hands of a number of people and control has spread, users of their financial statements can be grouped into two broad groups, namely internal users and external users. Parties included as internal users are company management and employees, while external users are creditors, government, and public shareholders who are not involved in company operations (Rasmini, 2002).

There are several different interests between management as agents and shareholders, creditors, and the government as principals that encourage conflicts that are detrimental to both parties, namely: (1) management wants to increase welfare, while shareholders want to increase wealth; (2) management wants to get as much credit as possible with low interest, while creditors only provide credit according to the company's ability; and (3) management tries to pay as little tax as possible while the government wants to collect the highest tax. The unification of interests between these parties often creates a problem called *agency conflict.*

Accounting policies that tend to be liberal lead to the act of "earnings management" by the management of the company, known as earnings management. Scott (2003) defines earnings management as the choice of accounting policies by managers to achieve certain goals. Earnings management practices have the potential to result in information asymmetry between managers as agents and shareholders as principals, especially when managers know more about internal information and future company prospects than shareholders and other stakeholders. The objectives of managers in carrying out earnings management actions allegedly for the benefit of the company are not necessarily in line with the needs of other users of financial statements.

The controversy regarding the pros and cons of earnings management practices is because information users, including shareholders, creditors, and the government, generally tend to pay more attention to profits, which has the potential to create information asymmetry. In fact, financial statements consisting of balance sheets, income statements, statements of changes in equity, cash flow statements, and notes to financial statements have an equally important role. Information asymmetry arises when managers know more about the company's internal information and future prospects than shareholders and other stakeholders. This is in accordance with Lev's (1989) statement that *earnings* are the main information presented in financial statements. Thus, the numbers in the financial statements, especially the bottom line, are important things that must be observed by users of financial statements. Beattie et.al. (1994) state that investors' attention is often focused on earnings information without paying attention to the procedures used to generate it, encouraging managers to carry out *earning* management or *earning* manipulations.

Schipper (1989) defines earnings management as an intervention with a specific intention to the external financial reporting process deliberately to obtain some personal benefits. Fischer and Rosenzweig (1995) define earnings management as the action of a manager by presenting a report that increases (decreases) the current period profit of the business unit he is responsible for, without causing an increase (decrease) in the unit's economic profitability in the long term. Meanwhile, according to Healy and Wahlen (1999), earnings management occurs when managers use *judgement* in financial reporting and transaction preparation to change

ISSN 2278-2540 | DOI: 10.51583/IJLTEMAS | Volume XIV, Issue VI, June 2025

financial statements, with the aim of manipulating the *magnitude* of earnings to some stakeholders about the company's economic performance or to influence the outcome of agreements (contracts) that depend on reported accounting numbers.

Healy and Wahlen (1999), state that the definition of earnings management contains several aspects. Firstly, earnings management intervention in financial reporting can be done with the use of judgement, for example judgement required in estimating a number of future economic events to be shown in the financial statements, such as estimates of the economic life and residual value of fixed assets, liabilities for pensions, deferred taxes, losses on receivables and impairment of assets. In addition, managers have a choice of accounting methods, such as the depreciation method and the cost method. Second, the objective of earnings management is to mislead stakeholders about the company's economic performance. This arises when management has access to information that is not accessible to outsiders. Three PAT hypotheses that can be used as a basis for understanding earnings management actions formulated by Watts and Zimmerman (1986) are:

The Bonus Plan Hypothesis

Managers who work for companies that implement bonus plans will try to adjust their reported earnings with the aim of maximising the amount of bonus they will receive. Company managers will prefer accounting methods that can shift earnings from the future to the present so as to increase current earnings. This is because managers prefer to pay higher wages for the present. In the bonus contract, two terms are known, namely bogey (the lowest level of profit to get a bonus) and cap (the highest level of profit). If earnings are below the bogey, no bonus is earned by the manager whereas if earnings are above the cap, the manager will not earn any additional bonus. If net profit is below the bogey, managers tend to minimise profit in the hope of getting a bigger bonus in the next period, and similarly if profit is above the cap. So only if net income is between bogey and cap, managers will try to increase the company's net income.

The Debt to Equity Hypothesis (Debt Covenant Hypothesis)

This hypothesis states that the closer a company is to the time of breach of debt covenants, managers will tend to choose accounting methods that can move future period profits to the current period in the hope of reducing the possibility of the company experiencing a breach of debt contracts. In companies that have a high debt to equity ratio, company managers tend to use accounting methods that can increase revenue or profit. Companies with a high debt to equity ratio will experience difficulties in obtaining additional funds from creditors and even the company is threatened with violating the debt agreement.

The Political Cost Hypothesis (Size Hypothesis)

This hypothesis states that companies with large scale and strategic industries tend to lower profits to reduce the level of visibility, especially during periods of high prosperity. This effort is made in the hope of obtaining facilities and facilities from the government. Political costs arise because high corporate profitability can attract media and consumer attention.

Several other studies also explain the motivation of management in earnings, including capital market motivation because there is an incentive for managers to manipulate earnings with the aim of influencing stock price performance in the short term. Several factors that can motivate managers to carry out earnings management (Scott: 2000), namely:

Bonus scheme

Healy (1985) showed empirically that before doing earnings management, managers have information from within the company on the company's net profit. If in a certain year the company's net profit is low (below bogey), the manager's action is to reduce revenue, so that the company's profit will be lower (taking a bath) which intends to achieve a bonus in the following year. Meanwhile, if in a certain year the company's net profit is high (above the cap), the action taken by the manager is to reduce revenue, so that the company's profit will be lower. This action is taken because the manager will not get a bonus that is higher than the predetermined target. The point is that managers will carry out earnings management when net income is between bogey and cap.

Long-term debt contract (Debt covenant)

Earnings management with the aim of fulfilling debt covenants arises from long-term debt contracts. Debt agreements aim to protect borrowers from manager actions. Violation of the covenant results in high costs to the company, therefore managers try to avoid violating the covenant.

Political motivation

Large companies whose activities are related to the public or companies engaged in strategic industries such as oil and gas will be very easy to monitor. Companies like this tend to manage their profits. In periods of prosperity the company uses accounting procedures and practices that minimise the company's net profit. Conversely, the public will encourage the government to increase regulations to reduce their profitability.

Taxation motivation

Tax saving motivation is the most obvious earnings management motivation. However, tax authorities tend to impose their own tax accounting rules to calculate taxable income. In general, taxation should not play a major role in earnings management decisions.

ISSN 2278-2540 | DOI: 10.51583/IJLTEMAS | Volume XIV, Issue VI, June 2025

Maydew (1997) research proves that tax savings are an incentive for managers (especially managers who experienced net operating loss in 1986-1991) to accelerate cost recognition and delay revenue recognition.

CEO (Chief Executive Officer) Change

Earnings management also occurs around the time of CEO turnover. The bonus program hypothesis predicts that as the time approaches for CEO resignation, the action taken is to maximise earnings to increase their bonus. Meanwhile, poorly performing CEOs will engage in earnings management to maximise their profits with the aim of preventing or delaying their dismissal.

Initial public offering

Companies going public do not yet have a market value, and cause the managers of these companies to perform earnings management in their prospectus. There is a possibility that managers of publicly listed companies will manage their prospectus in the hope of increasing the share price. Earnings management is done through accounting policy selection or by controlling accrual transactions. Accrual transactions are transactions that have no effect on cash inflows or outflows. Accrual transactions consist of discretionary and non-discretionary transactions.

Accountants' view that earnings management is not an act of fraud is also inseparable from their understanding of the meaning of "fraud" within the framework of their profession, especially as stated in the following Auditing Standard Section 316 (IAI 2001): Fraud is different from error. The factor that distinguishes between fraud and error is whether the underlying action, which results in a misstatement in the financial statements, is intentional or unintentional.

The same view is given by Kurniawan (tax auditor). Kurniawan believes that earnings management practices by managers are essentially no different from tax management practices carried out by taxpayers. According to him, tax management is not an act of fraud as long as it is carried out legally within the corridors of tax laws and regulations. Tax management is not a corrupt act, because taxpayers only get around the weaknesses that exist in tax laws and regulations. If weaknesses in tax regulations are not found by taxpayers, taxpayers usually get around the application of accruals allowed in tax accounting.

From a different perspective, it is interesting to listen to the view on earnings management practices by Mujianto (investment advisor). He said that: Whether done through any strategy, by violating accounting standards or not, earnings management practices are corruptive. I say as a corruptive act, because the practice is based on motivation and personal interests by putting aside the interests of other parties. Earnings management practices cause financial statement figures to be affected and favour the interests of managers.

The purpose of the practice is clear, namely to expect readers of financial statements who are the target of earnings management practices to make decisions in favour of the manager or company. This is detrimental to other parties. Mujianto's opinion seems very consistent with the IAI (2007) statement in KDPPLK paragraph 16 relating to the neutrality of financial statements, and PSAK No.1 (Revised 1998) paragraph 5 relating to the purpose of the following financial statements: Information should be directed to the general needs of users, and not dependent on the needs and desires of particular parties. There should be no attempt to present information that favours some parties, while it would disadvantage other parties with opposing interests. [KDPPLK paragraph 16]

The purpose of general purpose financial statements is to provide information about the financial position, performance and cash flows of the company that is useful for most users of the report in order to make economic decisions and show management's accountability for the use of resources entrusted to them. [PSAK No.1 Rev.1998 paragraph 5]

According to Mujianto, no earnings management is done without motivation or interest, either personal interest or company interest. "To achieve these interests, earnings management must be carried out deliberately and systematically". Based on normal reasoning and thought, the selection of accounting methods should be done without certain motivations and interests that provide superior benefits to one party over another. Furthermore, Mujianto asserted that earnings management practice is a corrupt behaviour driven by a corrupt mind. The statement that earnings management practices are not fraudulent as long as they are carried out without violating accounting standards, is a statement based on reasoning and thoughts that deviate from normal reasoning and thoughts. The mind is corrupted by consideration of legal or regulatory aspects, namely accounting standards. From a legal aspect, earnings management practices do not cheat accounting standards, but cheat the interests of other parties by making accounting choices systematically. Earnings management practices are unacceptable behaviour, because earnings management has implications for the loss of credibility of financial statements, adding to the bias of information in financial statements, thus disturbing users of financial statements who trust the engineered profit figures as profit figures without engineering.

In terms of religion, Islam is a source of values and ethics in all aspects of human life as a whole, including business discourse. Islam has a comprehensive insight into business ethics. Starting from the basic principles, points of damage in trade, factors of production, labour, capital organisation, wealth distribution, wage issues, goods and services, qualifications in business, to socio-economic ethics concerning property rights and social relations (Putra & Durachman, 2009).

In Islamic teachings, business ethics in Islam is built or based on axioms, namely: tawhid, unity (unity, wholeness); fairness, equilibrium (balance, harmony); free will (freedom); responsibility (responsibility); ihsan and benevolence (benefit) (Beekun, 1996).

ISSN 2278-2540 | DOI: 10.51583/IJLTEMAS | Volume XIV, Issue VI, June 2025

- Tauhid, unity (oneness, wholeness)
- Adil, equilibrium (balance, harmony)
- Free will (freedom)
- Responsibility
- Ihsan, benevolence (expediency)

Prophetic values according to Kuntowijoyo are based on three pillars based on Surah al Imron verse 110, known as ISP (Prophetic Social Science) with the mention of several elements, the first element

is humanisation. Humanisation is a creative translation of amar ma'ruf whose original meaning is to advocate or enforce. In Prophetic Social Science, humanisation means humanising humans, removing "materialism", dependency, violence and hatred from humans. With this concept, humans must centre themselves on God, but the goal is for the benefit of humanity's own virtue. The second element is liberation. Liberation is the creative interpretation of nahi munkar. Liberation in Prophetic Social Science is in accordance with the principles of socialism (marxism, communism, dependency theory, liberation theology). In the context of social science, prophetic means liberating humans from the cruelty of poverty, the extortion of abundance, the domination of oppressive structures and the hegemony of false consciousness. Furthermore, transcendence is the basis of the two elements above. Transcendence is a concept derived from tu'minûna billâh (faith in God). Transcendence wants to make transcendental values (faith) an important part of the process of building civilisation. (Kuntowijoyo: 1999)

When there is anxiety about western thought that leaves the transedental side, Islam becomes an alternative (Masyhuri 2013). Moreover, Islam has shown its universal scope by improving life patterns, both in the form of horizontal and vertical interactions (Djalaluddin 2012). This scope of Islamic universality will be the basis or main foundation in rebuilding divine accountability. This is due to the urgency of the view of secularity, duality, and fragmentation of modern accounting derived from neoclassical economic logic. The logic of neoclassical economics and accounting based on entity theory causes accountability that is financial in nature will always be separated from accountability from the humanist, social, and religious sides. Therefore, we intend to depart from the dichotomy of religion and science and unite them. We base Islam and Tawhid as the main view to make science (accounting) as part of religion.

II. Research Methods

This research uses descriptive qualitative research methods to describe and explain the observed phenomena. This research also

This research also uses secondary data as a source of information. This information is obtained through online sources, including official websites, e-books, articles, and previous research. This research examines earnings management in presenting an accountable report by incorporating ethical values interpreted from prophetic social science.

III. Discussion

The Islamic ethical system that they use as a guideline is an Islamic perspective ethical system based on the word of God, not based on the perception of certain individuals or communities. The Islamic ethical system has four main values, namely unity, equilibrium, free will and responsibility (Naqvi, 1994). This is consistent with the theoretical basis used by the author, namely the Islamic business ethics of Beekun, 1996. Based on the value of unity, business treats all parts as a whole. Everyone must be treated fairly, not cheating without discrimination. Meanwhile, the concept of equilibrium offers the principles of social responsibility and justice. The concept of free will gives humans the freedom to choose, but must still follow ethics. The concept of responsibility is related to the concept of freedom, freedom must be balanced with individual and group responsibility. Responsibility relates to the obligation to act in accordance with sharia.

The incompatibility of earnings management with Islamic business ethics can be seen from the review of various literatures. In the Islamic ethical system, the values contained are the values of unity, equilibrium, free will, and responsibility, as discussed in the research literature which shows that between earnings management and these values have a negative relationship, meaning that there is a mismatch between the two. Ibrahim (2010) argues that in earnings management there are elements of tadlis (fraud) and gharar (uncertainty) because there are parties who hide information from other parties (unknown to one party). Whereas in Islam, according to Islamic business ethics scholars, everything is delivered in real terms and there is no element of deception because this is clearly not in accordance with Islamic business ethics, especially the principles of fairness and mutual consent.

Islamic business ethics is an ethical system that upholds noble values, while earnings management has many negative impacts. The concepts of tawhid and unity are concepts that avoid unethical actions. Justice, equilibrium requires a balanced life, producing order, social security, putting everything in its place, and not causing harm to one party, not harming and being harmed. Meanwhile, earnings management has a negative impact on the economy, micro, macro, and even internationally. Fairness is also defined as its freedom from the elements of gharar and injustice, but in earnings management there is unclear information, information that is unknowable to one party and there are parties who get injustice from other parties because of the unfair information. The concept of free will and responsibility requires that the freedom possessed by humans be used responsibly and still within the corridors of

ISSN 2278-2540 | DOI: 10.51583/IJLTEMAS | Volume XIV, Issue VI, June 2025

Allah's rules, but the cases that occur show that the freedom possessed is used to fulfil personal interests and commit fraud against other parties (see PT Kimia Farma Tbk., Enron, Xerox, etc.). The concept of ihsan, benevolence requires the benefits of the world and the hereafter, while earnings management actually causes many parties to be unbeneficial.

In addition, earnings management that is disclosed reduces the quality of financial statements, reduces the quality of earnings, and the emergence of asymmetrical information is deemed incompatible with shiddiq, amanah, tabligh, fathonah which means transparent accountability, openness (disclosure), credibility (credible), true, honest, reliability, justice, caring, awareness, trustworthy, responsible, loyal to commitment, socialisation, internalisation, communication, information, leadership, exemplary, knowledge transfer, empathy, consistency, competence.

According to some managers, earnings management is considered a legitimate management tool to be used in fulfilling their responsibilities to shareholders, but from an ethical point of view, this action means a violation of public trust (Fischer and Rosenzweig, 1995). It should be noted that there is a good side of earnings management that must be understood, both from a contracting perspective and a financial reporting perspective (Scott, 2003). From the contracting perspective, earnings management is related to the efficient contracting versus opportunitic forms in Positive Accounting Theory (PAT).

From the efficient contracting perspective, earnings management is considered a reasonable or legitimate action to take, where management needs to be given the discretion to "adjust" net income when dealing with imperfect (incomplete) or rigid contracts in order to protect the interests of the parties involved in the contract. In this case, earnings management is carried out to protect management and the company in anticipating unexpected events for the benefit of stakeholders involved in the contract. Meanwhile, from the perspective of opportunitic forms, it needs to be understood that if the purpose of earnings management is only to increase management bonuses (opportunistic behaviour), it can be said that earnings management practices are actions that are not right or should not be done. Opportunistic public company managers as holders of inside information can reduce the reliability of the company for performance assessment, which external parties will find it difficult to know.

If traced further in the frame of ethics and spirituality, earnings management practices both seen from the efficient contracting and opportunitic forms, both contain elements of "lies" and "deception". Although in the perspective of efficient contracting, earnings management aims to "protect" stakeholders, but those who get "protection" are only stakeholders involved in the contract and not all related stakeholders, namely: management, shareholders, employees, creditors, government and society. In fact, the management of the company should be responsible for maintaining accountability in a company or organisation, so that no stakeholders are harmed by the existence of the organisation or company. Ludigdo (2004) states that accountability refers to the implementation of the accounting process and the production of financial reports that describe the company's actual financial condition.

Accountability was originally born due to the relationship between management (agent) and owners (principal), and (considered) to improve the provision of reliable, accurate, and trustworthy information (Kholmi, 2010 and Salle 2015). However, this right does not yet represent the full reality so that at this level the virtue of prophetic accountability is better able to capture reality because the orientation is based on worship for the universe and the people. Prophetic accountability is formed from three phases of life's spiritual journey, namely mortality, death, and life. First of all, mortality is the current state of modern accountability which is filled with lust so that it covers its inner eyes of a higher reality. Secondly, death means subduing the dimension of lust, it is no longer the guiding path in life, but must be subdued. The process of death itself consists of giving up and then serving oneself with full awareness to walk along a sacred genesis that will eventually be brought down, in this case in the intact building of prophetic accountability. Furthermore, the negation of the body, this is done because the "body" of accountability is a contractual container that is detached from all the relationships that exist around it. This is inseparable from agency theory as the root of prophetic accountability. Next is life in its positioning in the universe, this is the foundation as rahmatan lil alamin and worship that prophetic accountability will bring.

Referring to Kuntowijoyo (2007), social science should not be complacent in its attempts to explain or understand reality and then forgive it. However, the most important thing is the task of transformation towards divinity. Prophetic accountability is a movement of social transformation towards divinity. Humanisation is manifested from the mandate which is one of the foundations of prophetic accountability development. This humanisation means returning to his duty as a human being on this earth, namely to prosper the universe, both humans and other creatures so that there is no more exploitation in the name of accountability as a claim to the realisation of a perfect picture of economic reality. Nahi munkar is interpreted as liberation, liberating material orientations that can later move civilisation away from the centre of essence. The purpose of amar ma'ruf (humanisation) is to humanise accountability, which has undergone a dehumanisation process without a human face. Accountability has only become a corporate manifestation, a political machine, and an accountability tool that does not have a divine foundation. The goal of nahi munkar (liberation) is the liberation of accountability from corporate, structural, and extortionary cruelty. So far we have only been trapped in the space of capitalist hubris and technocratic consciousness. In the end all will lead to God. This is what we call transcendence, as in the definition of prophetic accountability itself that the centre of responsibility and trust is Allah SWT. The purpose of tu'minuna billah (transcendence) is to add a transcendental dimension to culture. Accountability has been very shackled by the flow of materialism so that a cleansing must be carried out that realises its nature, returning to the path of God which is full of grace for nature.

Humans are God's representatives on earth, implementing prophetic values, realising the welfare of humans and the universe. Trituwono (1997; 2000a; 2000b) in "Metaphor of trust", describes the world as a company and humans as its managers, creating

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and spreading welfare for stakeholders (humans) and the natural environment. Consequently, everything managers do must be based on sharia ethics.

The consequence of the "metaphor of trust" is the "metaphor of zakat." Zakat relates to the concept of corporate goals, not profit orientation, but zakat orientation. Zakat orientation in the sense of using the concept of zakat value as the basis of management operations and Islamic accounting construction.

The form of "zakat metaphor" in the context of accounting is seen in the concept of Islamic enterprise theory. Value-added statement, which is one of the elements of Shari'ah enterprise theory financial statements, provides more transparent information about the distribution of added value created by the company, including to direct participants and indirect participants. A form of concern for stakeholders and the natural environment, a manifestation of the duty of the khalifah to create and spread prosperity for all stakeholders (humans) and nature.

Profit sharing is profit sharing calculated from revenue after deducting fund management costs. In the Islamic system, this pattern can be used for the purpose of distributing the business results of Islamic financial institutions (Hardiwinoto, 2011). So profit sharing is a profit sharing calculation based on the net result of total revenue after deducting the costs incurred to obtain the revenue. In Islamic banking, the term that is often used is profit and loss sharing, where this can be interpreted as a division between profit and loss from the income received for the results of the business that has been done.

The profit and loss sharing system in its implementation is a form of agreement between financiers (investors) or capital managers (entrepreneurs) in carrying out economic business activities, where between the two of them will be bound by a contract that in the business if they get a profit will be shared between the two parties according to the ratio agreed at the beginning of the agreement.

Revenue in Islamic banking is the result received by the bank from the distribution of funds (investment) into productive assets, namely the placement of funds with other parties. This is the difference or excess number of productive assets with the results of bank revenue. Islamic banking introduces a system to the public with the term Revenue Sharing, which is a profit sharing system calculated from the total revenue of fund management without deducting the cost of fund management.

In shariate good corporate governance (SGCG), accountability or responsibility is not only limited to the owners of capital or creditors and the government, but more than that to fulfil the aspect of human submission as a hambah Allah, creativity as khalifatullah fil ardh. Triyuwono (2004) states that accounting ideally not only presents private costs and benefits for direct participants (shareholders, creditors, employees, government), but also presents public costs and benefits to indirect participants (the surrounding community, 8 groups of zakat recipients and the financial environment and natural environment).

Transparency, according to the OECD, is defined as the obligation to provide open, timely and clear and comparable information concerning the financial situation, company management and company ownership. This is equivalent to an honest attitude, which encourages the practice of full disclosure so that the information gap between the seller/company and the buyer/customer becomes narrow.

IV. Conclusion

Earnings management can basically be in accordance with Islamic values and principles by changing the form of actions taken. Earnings management can be done by applying the values of honesty, trustworthiness, fathanah and tabligh in the company's financial statements.

The company management should be responsible for maintaining accountability in a company or organisation, so that no stakeholders are harmed by the existence of the organisation or company. Accountability is a reference to the implementation of the accounting process and the results of financial statements that describe the company's actual financial condition.

Prophetic accountability produces three important pillars, namely amar ma'ruf (humanisation), nahi mungkar (liberation), and tuma'ninah billah. All three are important pillars of accountability as a driver of civilisation towards essence.

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