



CORPORATE SOCIAL REPORTING PRACTICES OF
ISLAMIC BANKS IN INDONESIA: FROM THE
PERCEPTIONS OF DIFFERENT STAKEHOLDERS

BY

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ABSTRACT

Corporate social reporting is one of the famous issue in the development of financial reporting system. The modern company is not only focus on economic matters but also social matters in order to maintain the existence in the society. Islamic banking is the unique industry that concerning on the development of Islamic financial institutions which is promoting the social responsibility from Islamic perspective. Islamic banks use annual reports as a media to inform social activities to their stakeholders. Therefore, this study aims to investigate the corporate social reporting of Islamic banks in Indonesia particularly on the perceptions of the stakeholders regarding the practices of corporate social reporting from Islamic perspective. In Indonesia, studies regarding stakeholders' perception on corporate social reporting from Islamic perspective particularly by Islamic banks are almost non-existence. Thus, providing solutions for study questions and presenting empirical evidence regarding corporate social reporting issues will certainly add a new dimension to the literature. This study examines the perceptions of selected stakeholders such as accountants of Islamic banks, members of *Sharī'ah* supervisory board, muslim accounting academicians, and customers of Islamic banks. This study adopts the questionnaire survey method to examine the perceptions of stakeholders on the practices of corporate social reporting from Islamic perspective by Islamic banks in Indonesia. The statistical analysis, both parametric and non-parametric, is used to measure the difference perceptions on several issues of corporate social reporting from Islamic perspective. The study found that the stakeholders of Islamic banks in Indonesia have positive responses and same views on corporate social reporting from Islamic perspective. *Secondly*, the stakeholders perceived that the spiritual and the social responsibility motivations have encouraged Islamic banks to disclose corporate social reporting from Islamic perspective. *Thirdly*, the stakeholders perceived that the lack of legal requirement, administrative difficulties, and not required by the accounting standards are some factors that discourage to disclose corporate social reporting from Islamic perspective. *Fourthly*, the stakeholders perceive that all information regarding corporate social reporting from Islamic perspective and also all potential users proposed in this study are important. Finally, this study may contribute to develop the awareness of the management of Islamic banks and the board of directors so as to promote the social responsibilities to the society and Muslim Ummah. This can strengthen the vision and mission of *maqasid Sharī'ah* through the practices of Islamic banks as the agent of change for other commercial institutions. Therefore, the reputation of Islamic banks will be better inline with the better commercial performance.

ملخص البحث

تعد التقارير الاجتماعية للشركات من اشهر القضايا الموجودة في تطوير انظمة التقارير المالية. الشركة الحديثة لا تركز على الأمور الاقتصادية فقط ولكنها تركز أيضا على القضايا الاجتماعية من أجل الحفاظ على وجودهم في المجتمع. تعتبر المصرفية الإسلامية الصناعة الفريدة التي تتعلق بتطوير المؤسسات المالية الإسلامية التي تعزز المسؤولية الاجتماعية من منظور إسلامي. تستخدم المصارف الإسلامية التقارير السنوية كوسائل إعلامية لإبلاغ الأنشطة الاجتماعية لأصحاب المصلحة. ولذلك ، تهدف هذه الدراسة إلى تحقيق تقارير الاجتماعية للشركات للمصارف الإسلامية في إندونيسيا من جانب تصورات أصحاب المصلحة فيما يتعلق بممارسات إبلاغها من منظور إسلامي. تكاد الدراسات عنها في إندونيسيا غير موجودة، فلذلك إن توفير اجوبة لأسئلة هذه الدراسة وتقدم الادلة التحريية التي تتعلق بإبلاغ تقارير الاجتماعية للشركات سيكون شيئا جديداً في هذا المجال. تحلل هذه الدراسة ادراك أصحاب المصلحة المختارين مثل المحاسبين للمصارف الإسلامية وأعضاء مجلس الرقابة الشرعية والمحاسبة الأكاديمية الإسلامية وعملاء البنوك الإسلامية. تتبنى هذه الدراسة طريقة المسح الاستبياني لفحص تصورات أصحاب المصلحة حول ممارسات الإبلاغ الاجتماعي للشركات من منظور إسلامي من قبل البنوك الإسلامية في إندونيسيا. تستخدم هذه الدراسة التحليل الإحصائي ، سواء كان حدوديا اوغير حدوديا، لقياس تصورات الفرق على عدة قضايا في الإبلاغ عن التقارير الاجتماعية للشركات من منظور إسلامي. ووجدت الدراسة أن أصحاب المصلحة في البنوك الإسلامية في إندونيسيا لديهم ردود إيجابية ونفس وجهات النظر حول الإبلاغ عن التقارير الاجتماعية للشركات من منظور إسلامي. ثانياً ، رأى أصحاب المصلحة أن دوافع المسؤولية الروحية والاجتماعية شجعت البنوك الإسلامية على الكشف عن التقارير الاجتماعية للشركات من منظور إسلامي. ثالثاً ، رأى أصحاب المصلحة أن عدم وجود المتطلبات القانونية ، والصعوبات الإدارية ، وعدم طلب المعايير المحاسبية هي بعض العوامل التي لا تشجع على الكشف عن التقارير الاجتماعية للشركات من منظور إسلامي. رابعاً ، يدرك أصحاب المصلحة أن جميع المعلومات المتعلقة بالإبلاغ الاجتماعي للشركات من منظور إسلامي وكذلك جميع المستخدمين المحتملين الذين تم اقتراحهم في هذه الدراسة هي أمور مهمة. وأخيراً ، تسهم هذه الدراسة في تنمية الوعي على اصحاب المسؤولية بإدارة البنوك الإسلامية لتعزيز المسؤوليات الاجتماعية تجاه المجتمع والأمة الإسلامية. هذا يمكن أن يعزز رؤية ورسالة المقاصد الشرعية من خلال ممارسات البنوك الإسلامية كعامل تغيير للمؤسسات التجارية الأخرى. لذلك ، ستكون سمعة البنوك الإسلامية أفضل سواسية بحسن أداء التجاري الأفضل.

APPROVAL PAGE

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DECLARATION

I hereby declare that this thesis is the result of my own investigations except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
AOSSG	Asian-Oceanian Standard-Setters Group
BAZNAS	Badan Amil Zakat Nasional
BCA	Bank Central Asia
BMI	Bank Muamalat Indonesia
BNI	Bank Negara Indonesia
BPD	Bank Pembangunan Daerah
BRI	Bank Rakyat Indonesia
BSM	Bank Syariah Mandiri
BSMI	Bank Syariah Mega Indonesia
CSR	Corporate Social Responsibility
DPS	Dewan Pengawas Syariah
DSN	Dewan Syariah Nasional
e.g.	<i>(exempligrantia)</i> : for example
et al.	<i>(et alia)</i> : and others
GAAP	Generally Accepted Accounting Principles
IAI	Ikatan Akuntan Indonesia
IASB	International Accounting Standard Board
IASC	International Accounting Standards Committee
IFI(s)	Islamic Financial Institution(s)
IFRS	International Financial Reporting Standard
IRTI	Islamic Research and Training Institute
i.e.	<i>(id est)</i> : that is
KDPPLKS	Kerangka Dasar Penyajian dan Pengungkapan Laporan Keuangan Syariah
MUI	Majelis Ulama Indonesia
No.	Number
OJK	Otoritas Jasa Keuangan
PBI	Peraturan Bank Indonesia
PSAK	Pernyataan Standar Akuntansi Syariah
SFA	Statement of Financial Accounting
SSB	<i>Shari'ah</i> Supervisory Board

CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION

Issues of social justice and social accountability are matters of concern to the Muslim society (Kamla and Rammal, 2013). Furthermore, the research of accounting and accountability from the perspective of Islam has also grown among academics (Dusuki & Dar, 2005; Maali, Casson & Napier, 2006). The focus of the current issues are the accountability in the Islamic financial institutions due to the unique characteristics of them compared to conventional financial institutions. The conventional institutions are very much concern on the capitalist and socialist although they failed to realize the goals of economic efficiency and equity performance through strategies developed by secular worldviews (Chapra, 1992).

Furthermore, the secular worldview tries to promote accountability to limited stakeholders particularly to the shareholders. On the other hand, Islamic financial institutions have a broader accountability that cover dual accountability as follows: accountability to human being and ultimate accountability to the God (Al-Attas, 1993). This concept will affect to the behavioural model of Islamic financial institutions that concern on the fulfillment of *Sharī'ah* compliance. Islamic financial institutions have transcendental orientation that gives moral values as the responsibility to the God.

Kamla and Rammal (2013) argued that Islamic banks were the most innovative Islamic institutions as they are the fastest development institutions in the Islamic economic system. They provide products and services that are inline with *Sharī'ah*

principles and accommodate the need of the market on financial intermediaries. They now operate in Western countries as well as most of the Islamic countries. Currently, there are around 500 Islamic banks in more than 70 countries. At the end of 2011, their assets amounted to around US\$ 1.3 trillion and suggested an average annual growth of 19% over the past four years (Ernst & Young, 2012).

Many research in Islamic accountability and accounting from Islamic perspective criticized and analyzed the accounting practices and disclosure mechanism in Islamic banks such as Hamat (1994), Adnan and Gaffikin (1997), Sulaiman (2000), Shahul Hameed and Yaya (2003), Haniffa and Hudaib (2004, 2007), Shahul Hameed, Wirman, Alrazi, Mohamed-Nor, and Pramono (2004), Farook and Lanis (2005), Sulaiman and Abdul-Latiff (2005), Maali et al. (2006), Paino, Bahari, and Rosliza (2011), and Kamla and Rammal (2013).

Adnan and Gaffikin (1997) argued that Zakat was an important aspect that need to be considered by Islamic financial institutions as it was purifying the assets of the shareholders. Therefore, Islamic accounting should be concern on the development of accounting system that accommodated Zakat as an instrument in the disclosure of financial reporting. On the other hand, Kamla and Rammal (2013) concluded that the disclosures by Islamic banks explored in this study do not indicate that Islamic banks have serious schemes targeting poverty elimination or enhancing social justice in society. Paino et al. (2011) argued that most Islamic banks disclose information which was complied with Bank Negara Malaysia (BNM) guidelines only. It was indicated that some scholars of Islamic accounting and reporting are very concern on the accountability of Islamic financial institutions particularly on the activities that are related to religious matters.

Kamla and Rammal (2013) argued that Moslem world was affected by western values, therefore it was difficult to implement *Sharī'ah* principles as the domination of secular system. Secular values also affected Islamic banking governance since its accountability still focused too much on economic goals rather than social perspective. Chapra (1992) argued that capitalism thus became a system that provides the highest value on the freedom that allows individuals to pursue interests and maximize the wealth and satisfaction. Therefore, capitalism seems to bring the spirit of freedom in economic operation without any borders of value judgments from religion and government intervention.

Accountability of Islamic banks in doing their operation could be reported by the disclosures in annual report for both economic and social aspects. Economic aspects still became the major issues in most previous researches (Maali et al., 2006). While social aspects were also important because Islamic banks have been described as having “a social face” (Mashhour, 1996: 33). It means that they should also take care of their environment and society around them. Furthermore, Islamic banks are not only accountable to limited stakeholders, but also society. Kamla and Rammal (2013) examines social reporting by Islamic banks with special emphasis on themes related to social justice. They explored the social reporting of 19 Islamic banks in 11 countries. They found that the Islamic banks’ disclosures emphasize their religious character through claims that they adhere to *Sharī'ah* teachings. Their disclosures, however, lack of specific or detailed information regarding schemes or initiatives of poverty eradication or enhancing social justice. They still focus on economic matters rather than social justice issues. Similarly, Maali, et al. (2006) found that social issues were not the majors concerned for the most of Islamic banks observed. This was contradicting with the theory that there is a need for information of social activities by society.

Kamla and Rammal (2013) suggested that more research were needed to explore the other perspectives of social reporting by Islamic banks such as stakeholders' perceptions of customer, depositors or Muslims' communities. Therefore, this research attempts to examine the corporate social reporting by Islamic banks in Indonesia from the perspectives of different stakeholders.

Indonesia is a unique country since it has a biggest number of Muslim in the world and the government intends to support the growth of Islamic bank and finance industries (CIA, 2007). The population of Muslim in Indonesia approximately 86.1% from almost 220 million people and the world's most populous Muslim-majority nation (CIA, 2007). Ernst and Young (2012) reported that Indonesia is one of the potential international market of Islamic finance industry besides Saudi Arabia, Malaysia, Qatar, and Turkey.

Specifically, this research examines the perceptions of various groups of stakeholders, such as accountants, academics, depositors, and members of *Sharī'ah* Supervisory Board (SSB) on several issues such as: (i) the main objectives of corporate social reporting from Islamic perspective; (ii) the factors that discourage Islamic banks from disclosing corporate social reporting from Islamic perspectives; (iii) the encouraging factors of banks for disclosing corporate social reporting from Islamic perspectives; (iv) potential users of corporate social reporting from Islamic perspectives; and (v) the type of information of corporate social reporting from Islamic perspectives;

1.2 AIMS OF THE STUDY

This research focuses to investigate the perspectives of different stakeholders on the corporate social reporting by Islamic banks in Indonesia based on several reasons: Firstly, Islamic banks uses maqasid *Sharī'ah* as the guidance in operating the products and services in order to fulfill the *Sharī'ah* principles. Secondly, the main roles of Islamic banks should be balance in both business and social activities. Thirdly, Islamic banks have dual responsibilities both to the God and human beings that are represented by stakeholders. Islamic banks have differences in disclosures compare to conventional banks particularly on the aspects that related to *Sharī'ah* components such as: zakat management, the treatment of non-halal income and distribution, and the roles of *Sharī'ah* supervisory board members.

1.3 MOTIVATIONS OF THIS STUDY

Corporate social reporting from Islamic perspective is one of the major issue in accountability of Islamic financial institutions discussion due to some reasons: First, Moslem communities need a new model of banking system that operates in accordance with *Sharī'ah* principles, puts forward the values of justice, easy to access, and prioritize the moral values as the main orientation (Kamla & Rammal, 2013). Moslem communities perceive that conventional banks prefer to focus on economic activities and profit orientation by implementing interest rate as the main tool in funding and lending operations. So that, they hope that Islamic banking is not only focusing on profit but also social aspects such as preservation of *Zakāh*, *Qard al-Hasan* transaction, and other social activities that can improve the wealth of the Moslem *Ummah*. Therefore, social reporting should be one way of showing accountability of Islamic banks. However, based on the previous research, the current

practices of Islamic banking on social reporting is still very limited (See Farook & Lanis, 2005; Maali et al., 2006; Haniffa & Hudaib, 2004, 2007; and Paino, Bahari & Rosliza, 2011). By implementing corporate social reporting, the management of Islamic banks are forced to prioritize the social activities in order to fulfill the need of the stakeholders.

Secondly, many studies in the conventional organizations have concerned on a corporate social responsibility disclosure since a long time ago (e.g. Ingram (1978), Bubzy and Falk (1979), Gray, Owen, and Maunders (1987), Belkaoui and Karpik (1989), Guthrie and Parker (1989), Ness and Mirza (1991), Roberts (1992), Epstein and Freedman (1994), Williams and Pei (1999), Depoers (2000), and Woodward, Edwards, and Birkin (2001)). Initially, most companies have considered social responsibility as a passive response to social pressure from external sides. Currently however, companies are positively responding to corporate social responsibility demands (Elasrag, 2015). Over the years, corporate social responsibility has developed from the classical 'profit-centred model' to the modern 'socially responsible model' (Carrol, 2008). Therefore, companies need to allocate their profits into social activities that have optimal values in order to achieve their goals in maintaining their existence in the society and serving the community as the consequences of their operation and utilization of resources.

On the other hand, researches in corporate social corporate responsibility disclosures would make companies become more aware of the importance of social disclosure to their existence and performance. However, the conventional organizations only understand corporate social reporting to the extent of maintaining its existence in society and to enhance the company's reputation. Corporate social reporting is implemented not on the basis of management awareness of the duty as a

man who has Divine awareness. This is one of the fundamental differences with corporate social reporting in the Islamic perspective.

Islamic banking sector tries to promote the products and services that have welfare of society orientation rather than individualistic profit motive. However, the practices of Islamic banks still far from the ideal orientation due to some constraints particularly reflected in the corporate social reporting by Islamic banks. The previous research have tried to investigate the current practices of corporate social reporting from Islamic perspective particularly by Islamic banks such as Maali et al. (2006) and Kamla and Rammal (2013). However, very limited research that are concern on the views of the stakeholders of corporate social reporting from Islamic perspective. One of the research that was concerned in corporate social responsibility in Islamic financial institutions was done by Asyraf-Wajdi (2008).

He studied the perceptions of Islamic banks' stakeholders on the philosophy and objectives of Islamic banking in Malaysia by using conventional approach of corporate social responsibility. There were four areas addressed: (1) the environmental dimension; (2) the human resource dimension; (3) the philanthropic dimension; and (4) the human rights dimension. However, this research was not try to scrutinize the views of the stakeholders on the corporate social reporting practices especially from Islamic perspective. He tried to elaborate the western perspective of corporate social responsibility and to infuse some relevant Islamic values in that perspective for example the environmental dimension was relevant with Qur'an (2:205) that explained "And when he goes away, he strives throughout the land to cause destruction therein and destroy crops and animals. And Allah does not like mischievous act". On the other hand, this research tries to focus on the corporate social reporting from Islamic perspective particularly on the elements social reporting