



STAKEHOLDERS' PERCEPTIONS OF ISLAMIC
SOCIAL REPORTING BY ISLAMIC BANKS:
MALAYSIAN EVIDENCE

BY

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ABSTRACT

Islamic banks are one of the most important Islamic institutions. In theory, Islamic banks are also unique institutions, as they should not only focus on economic matters but also should focus on their social roles to their society. Islamic social reporting emerges as an alternative to fill this gap. Islamic social reporting is the process of identifying, providing, and communicating social and other relevant information in conformity with the spiritual need of Muslims decision makers in order to demonstrate accountability to God and community; to increase transparency of business activities toward Muslim *Ummah*; and to achieve *Mardātillah* (blessing from Allah). This study investigates the stakeholders' perceptions of Islamic social reporting by Islamic banks in Malaysia since this country is at the forefront on the development of Islamic banking and finance. This study specifically examines the stakeholders' perceptions on several issues of Islamic social reporting such as: (a) the objectives of Islamic social reporting; (b) the factors that inhibit Islamic banks in disclosing Islamic social reporting; (c) the motivations of Islamic banks to disclose Islamic social reporting; and (d) the information that might be useful for the stakeholders and society. The study examines the perceptions of selected stakeholders such as Islamic banks' accountants, members of *Shari'ah* Supervisory Board (SSB), Muslim accounting academicians, and customers that are proxies by postgraduate students. This study adopts the questionnaire survey method to examine the perceptions of stakeholders. The statistical analysis, both parametric and non-parametric, was used to measure the difference perceptions on several issues of Islamic social reporting. The study found that the stakeholders of Islamic banks in Malaysia have positive views on Islamic social reporting. Secondly, the stakeholders perceived that the spiritual and the social responsibility motivations have motivated Islamic banks to disclose Islamic social reporting. Thirdly, the stakeholders perceived that the regulation and the stakeholders' awareness have dominated the factors that inhibited Islamic banks from disclosing Islamic social reporting. Finally, this study may contribute to the improvement of Islamic banking financial and social reports and will improve the awareness of the regulators and the management of Islamic banks in Malaysia as well as other countries.

ملخص البحث

تعدُّ المصارفُ الإسلامية واحدةً من أكثر المؤسسات الإسلامية أهميةً. ومن الناحية النظرية، يتبن أيضاً أن المصارف الإسلامية من المؤسسات الفريدة من نوعها، لِمَا أنَّها لا تركز على المسائل الاقتصادية فحسب، ولكنها تركز كذلك على تعزيز دورها الاجتماعي لمجتمعها. ويظهر الإبلاغ الاجتماعي الإسلامي بوصفه بديلاً لملء هذه الفجوة بين المؤسسة والمجتمع. علماً بأن ذلك الإبلاغ يُعنى به عملية تحديد وتوفير ونقل المعلومات للمجتمع ذات الارتباط الاجتماعي وغيره وفقاً لحاجة روحية للمسلمين بوصفهم صانعي القرار من أجل تحقيق المسؤولية أمام الله وأمام المجتمع؛ كل ذلك لزيادة الشفافية في الأنشطة التجارية تجاه الأمة الإسلامية، ورغبة في تحقيق مرضاة الله. هذه الدراسة تتناول تصورات أصحاب المصلحة لتقديم التقارير الاجتماعية الإسلامية من قبل المصارف الإسلامية في ماليزيا حيث كان هذا البلد يعتبر في الطليعة على تطوير العمل المصرفي والتمويل الإسلامي. كما أن الدراسة تبحث في وجه التحديد تصورات أصحاب المصلحة بشأن عدَّة قضايا من التقارير الاجتماعية الإسلامية مثل: (أ) أهداف الإبلاغ الاجتماعي الإسلامي، (ب) العوامل التي تحوّل دون الكشف عن المصارف الإسلامية في الإبلاغ الاجتماعي الإسلامي، (ج) الدوافع للمصارف الإسلامية للكشف عن الإبلاغ الاجتماعي الإسلامي، و(د) المعلومات التي قد تكون مفيدة لأصحاب المصلحة والمجتمع. والدراسة تبحث كذلك في تصورات أصحاب المصلحة المختارين، مثل المحاسبين في المصارف الإسلامية، وأعضاء هيئة الرقابة الشرعية، والمحاسبين المسلمين الأكاديميين، والعملاء الذين تمّ اتقاؤهم من قبل وكلاء طلاب الدراسات العليا. وهذه الدراسة تعتمد على منهج مسح الاستبيان لدراسة تصورات أصحاب المصلحة. واستخدام منهج التحليل الإحصائي، سواء المَعْلَمِيّ (البارامترية/parametric) وغير المَعْلَمِيّ (اللابارامترية/non-parametric)، لقياس التصورات المختلفة على عدة قضايا من الإبلاغ الاجتماعي الإسلامي. ووجدت الدراسة أن لأصحاب المصارف الإسلامية في ماليزيا وجهات نظر إيجابية بشأن تقديم التقارير الاجتماعية الإسلامية. وثانياً، أن أصحاب المصلحة أدركوا أن دافع القناعة الروحية والمسؤولية الاجتماعية قد شجعت المصارف الإسلامية للكشف عن الإبلاغ الاجتماعي الإسلامي. ثالثاً، أن أصحاب المصلحة أدركوا كذلك أن تنظيم ووعي أصحاب المصلحة قد سيطر على العوامل التي تحوّل دون المصارف الإسلامية من الكشف عن الإبلاغ الاجتماعي الإسلامي. وأخيراً، فإن هذه الدراسة قد تسهم في تحسين الخدمات المصرفية الإسلامية والمالية والتقارير الاجتماعية ومن ثمّ ستحسّن مستوى الوعي لدى الجهات التنظيمية وإدارة المصارف الإسلامية في ماليزيا فضلاً عن دول أخرى.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science in Accounting.

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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.

Rifqi Muhammad

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BY ISLAMIC BANKS: MALAYSIAN EVIDENCE**

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LIST OF ABBREVIATIONS

AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
ABIC	Al Rajhi Banking and Investment Corporation
AFBB	Asian Finance Bank Berhad
AFIBB	Affin Islamic Bank Berhad
AIBB	Alliance Islamic Bank Berhad
AMIBB	AmIslamic Bank Berhad
BAFIA	Banking and Financial Institutions Act 1989
BIMB	Bank Islam Malaysia Berhad
BMMB	Bank Muamalat Malaysia Berhad
BNM	Bank Negara Malaysia
BR	Bank Rakyat
CIMBIBB	CIMB IB Berhad
e.g.	<i>(exempligrantia)</i> : for example
et al.	<i>(et alia)</i> : and others
IDB	Islamic Development Bank
IFI(s)	Islamic Financial Institution(s)
IUM	International Islamic University Malaysia
IRTI	Islamic Research and Training Institute
EONIBB	EONCAP Islamic Bank Berhad
HLIBB	Hong Leong Islamic Bank Berhad
HSBCAMB	HSBC Amanah Malaysia Berhad
i.e.	<i>(id est)</i> : that is
KFHMB	Kuwait Finance House Malaysia Berhad
MBIB	May Bank Islamic Bank Berhad
MASB	Malaysian Accounting Standard Board
MBA	Master of Business Administration
MEc	Master of Economics
MMgt	Master of Management
MSc	Master of Science
No.	Number
PIBB	Public Islamic Bank Berhad
RHBIB	RHB Islamic Bank Berhad
SCSB	Standard Chartered Saadiq Berhad
SFA	Statement of Financial Accounting
SSB	<i>Shariah</i> Supervisory Board
OCBCABB	OCBC Al Amin Bank Berhad

CHAPTER ONE

INTRODUCTION

1. 1 INTRODUCTION

Recent decades, the discussion and research of accounting and accountability from the perspective of Islam has grown among academics (Maali, Casson, and Napier, 2006). The concern was particularly on the accountability in Islamic institutions since they have difference characteristics compared with the conventional institutions. Conventional institutions derived from capitalist and socialist systems have operated in the economic world since a long time ago. However, Chapra (1992) argued that both the capitalist and socialist systems were unable to realize the goals of both efficiency and equity by means strategies based on the secularist enlightenment worldview. Thus, Chapra (1992) suggested that Muslim should realize *Maqāsid al-Sharī'ah*, which is far more comprehensive in their coverage of elements essential for overall human being than any secularist system, since Islam provides a system that promotes human well-being in accordance with the concepts of brotherhood and socio-economic justice.

On the other hand, secularist worldview has driven conventional institutions such as companies only accountable to the limited stakeholders especially the shareholders. While Islamic institutions have broader accountability that encompasses not only their stakeholders but also more importantly to God. God in Islam has central position since the Muslims believe in God because He is the Creator and Provider, for bringing them into existence and maintaining them in their existence (Al-Attas, 1993). Therefore, Muslims are accountable to God, and their success in the hereafter depends

on their performance in this life on earth (Siddiqi, 1981). Consequently, this concept encourages Islamic institutions to place the ultimate accountability to God beside their stakeholders. This condition will affect those institutions to behave differently comparing to their counterparts.

Maali et al. (2006) argued that Islamic banks were the most attractive Islamic institutions since they are the fastest growing institutions in the Islamic financial system. Islamic banks provide financial products that do not violate *Sharī'ah*, the Islamic law of human conduct. They now operate in Western countries such as the UK and USA, as well as most of the Islamic countries. Currently, there are around 300 Islamic banks in more than 70 countries. At the beginning of 2007, their assets amounted to around US\$ 300 billion (*Sharī'ah* Finance Watch, 2008).

Many research in Islamic accounting and accountability criticized and analyzed the accounting practices and reporting system in Islamic banks around the world 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), and Maali et al., (2006).

Karim (1999) said that Islamic banks were established with the mandate to carry out their transactions in strict compliance with Islamic law (*Sharī'ah*). It was generally believed that Islamic banking started to depart as the consequences of the boom in the oil prices in 1973 to 1974. In addition, Karim (1999) noted that in certain countries (such as Pakistan and Sudan) the whole banking system had been completely transformed to comply with Islamic *Sharī'ah*.

Maali et al. (2006) argued that Islamic society was affected by western cultural values, therefore it is difficult to implement a full Islamic system because the

domination of capitalist system. This also affected Islamic banking accountability since its accountability still focused too much on economic goals rather than social perspective. Chapra (1992) argued that capitalism thus became a system which gave the highest value to unfettered freedom to enable the individual to pursue his self-interest and to maximize his wealth and want 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 can be partly affiliated by the disclosures in annual report from both economic and social aspects. Economic aspects still became the major issues in most previous researches (Maali et al., 2006: 266). 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 in around them. Furthermore, Islamic banks are not only accountable to limited stakeholders, but also society. Maali et al. (2006) explored the nature and extent of social reporting by Islamic banks of 29 full-fledged Islamic banks in 16 countries. They found that social issues were not of majors concern for the most of Islamic banks observed. This was contradicting with the concept of accountability because the Islamic banks should provide the relevant information of their activities as the form of their accountability to the society.

This research attempts to explore the needs for social reporting by Islamic banks from the perspectives of selected users in Malaysia. Malaysia is a unique country since it has focused its efforts in developing Islamic banks (Schmith, 2007). Specifically, this research examines the perceptions of various different groups, such as accountants, academics, depositors, and members of *Shari'ah* Supervisory Board (SSB) regarding several issues such as: (i) the main objectives of Islamic social

reporting; (ii) the factors that inhibit and motivate Islamic banks from disclosing Islamic social reporting; (iii) the kinds of information of Islamic social reporting that should be disclosed by Islamic banks to its potential groups of users.

1.2 AIMS OF THE STUDY

The researcher is interested to investigate the stakeholders' perceptions of Islamic social reporting by Islamic banks in Malaysia based several reasons: First, Islamic banks have unique characteristics and operations especially because it is in accordance to *Sharī'ah* principles. Secondly, in theory, the main functions of Islamic banks should be both business and social activities. Thirdly, Islamic banks are not only responsible to shareholders and depositors, but also other stakeholders (such as to Muslim public) including suppose to compliance to *Sharī'ah* principles and operate in Islamic business environment.

Based on above reasons, researcher has aims to examine the stakeholders' perceptions of Islamic social reporting by Islamic banks. Beside the issues of Islamic social reporting objectives and the factors influencing Islamic banks to disclose Islamic social reporting, this research tries to find the information that might be useful for the stakeholders and society. It also involves some stakeholders such as Islamic banks' Accountants (IBAs), Members of *Sharī'ah* Supervisory Board (SSB), Muslim Accounting Academicians (MAAs), and Customers that are proxies by Post Graduate Students (PGSs). Moreover, this study specifically aims to examine several issues on social reporting by Islamic banks in Malaysia as follows: Firstly, the stakeholders' perceptions on the main objectives of Islamic social reporting. Secondly, the stakeholders' perceptions on the factors that inhibit Islamic banks from disclosing Islamic social reporting. Thirdly, the motivations for Islamic banks to disclose Islamic

social reporting. Fourthly, the stakeholders' perceptions on the information that to be disclosed in Islamic social reporting to its potential groups of users.

1.3 MOTIVATIONS OF THIS STUDY

Social reporting by Islamic banks is the major issue in Islamic banking discussion because of several reasons: First, Islamic communities' need for a new model of banking that serves more justice and easy to access. They perceive that conventional banks prefer to focus on economic activity and profit orientation by using interest rate. Moreover, they also hope that Islamic banking is not only focusing on profit but also social aspects such as preservation of *Zakāh*, *Qard al-Ḥasan* transaction, and other social activities that can improve the wealth of the *Ummah*. Therefore, social reporting should be one way of showing accountability of Islamic banks.

Second, many studies in the Western companies 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 Fredman (1994), Williams and Pei (1999), Depoers (2000), and Woodward, Edwards, and Birkin (2001)). This is interesting because Western companies are very much concerned on the economic aspects rather than social aspects (Haniffa, 2002). Researches in social corporate responsibility disclosures would make companies become more aware of the importance of social disclosure to their image and performance.

Islamic banks, that declare to implement dual-functions in both economic and social simultaneously, should be better than conventional companies. Researcher analyzes that there are still few concern in social reporting by Islamic banks especially

in academic discussions. Currently, there was a research done by Maali et al. (2006) and published in an international journal. However, the research only examined the current practices without confirming the perceptions of stakeholders that potentially used social information.

Third, Malaysia is one of the strongest players in the Islamic financial industry (Islamic Finance Asia, 2008). Yakcop (2006) added that Malaysia is currently at the forefront of the development of Islamic financial system because of its efforts to develop a banking sector, non-banking sector, Islamic money market and Islamic capital market. Moreover, according to the data of PricewaterhouseCoopers in 2007, Malaysia has Islamic banking assets of RM100.3 billion (US\$30.9 billion) while its *Takāful* assets amount to RM5.5 billion (US\$1.7 billion). Islamic private debt securities account for 45.5% or RM110 billion (US\$34 billion) of the whole market, and an active Islamic money market moves between RM30 billion (US\$9.2 billion) and RM40 billion (US\$12.3 billion) monthly. These are indications that Malaysia is ceaseless in being innovative and proactive in promoting Islamic finance (Islamic Finance Asia, 2008).

However, the ability of Malaysia in encouraging Islamic financial system should be balanced with the growth of social responsibilities to their society since they have reached almost mature position in the world of Islamic finance. Wilson (2001) argued that the issue of social responsibility and ethical banking is of relevance for those involved in Islamic banking and finance since the institutions are formed based on the spirit of divine revelation. Therefore, those institutions should place social responsibility as the core component of the success of Islamic banks' operation.

Based on the reasons above, the social reporting may benefit for improving Islamic banking system towards more compliance to *Shari'ah* principles. This also

motivates this research to explore the stakeholders' perceptions of social reporting by Islamic banks. In order to give a better evaluation, the researcher will improve and modify the benchmark of social disclosure proposed by Maali et al. (2006) so that, the benchmark would be more suitable for the context and condition of Islamic banks in Malaysia. Finally, the study may contribute to the development of Islamic banking reports.

1.4 PROBLEM STATEMENT

An Islamic bank is the financial institution that deals with a number of players and stakeholders. Chapra and Ahmed (2002) raised the issue about the important actions of IFIs to safeguard the interests of stakeholders through some actions that lead to greater transparency and accountability. Moreover, Chapra and Ahmed (2002) argued that the most important stakeholder in the case of Islamic finance is Islam itself. Chapra and Ahmed (2002) reasoned that if, let say, Islamic banks do not perform well, those who assumed the Islamic system to be out of tune with the modern world may try to blame Islam for the poor performance although Islam have nothing to do with it.

Hasan (2008) stated that components of stakeholders does not necessary refer to only the shareholders or to those who have active participation in the decision making process but it involves non-investor or non-owner stakeholders for example any party who has direct or indirect participation in the corporation. Moreover, Hasan (2008) also mentioned other relevant stakeholders particularly on Islamic financial institutions such as employees, depositors, customers, and importantly *Sharī'ah* board members since they play a role to advise and supervise the operation of the company to ensure that it complies with *Sharī'ah* principles.

Sulaiman (2005) point out that individual, on behalf of the company, should also be accountable to society although the ultimate accountability is to God. Thus, stakeholders of Islamic banks as a part of the society have the rights of information the banks' operation. It can be provided through the various media such as annual report, newsletter, and information in the official website. Sulaiman (2005) also noted that social aspect is one of the important elements in Islamic corporate reporting since it could provide the social impact of firms' activities in Islamic societies.

The framework for the model of social reporting from Islamic perspective in this research is based on the normative values of Muslims that is also combined with the contemporary practices by some Islamic banks that is in line with *Sharī'ah* principles. However, Sulaiman (2005) argued that sometimes what Muslims actually desire might not accord with the ideal model proposed from an Islamic perspective since their need of information could be different from the proposal. Therefore, this research focuses on the perceptions of stakeholders of Islamic banks in order to examine the responses of various groups of stakeholders regarding the social reporting by Islamic banks particularly in Malaysia. Accordingly, researcher proposes the problem statement as follows: What are the stakeholders' perceptions of social reporting by Islamic banks in Malaysia?

1.5 CONTRIBUTION OF THE STUDY

As an extensions study in social reporting by Islamic banks from difference point of view, the researcher expects that this study will give contributions to the betterment of Islamic banking reports such as to: Firstly, the study provides additional evidences of the need for social reporting by Islamic banks in Malaysia. The evidences will strengthen the issue of social reporting by Islamic banks. Thus, society will get benefit

from the increasing attention of Islamic banks through social activities.

Secondly, the study improves the kinds of information of social reporting by Islamic banks by evaluating and proposing new possible items in the questionnaire based on an Islamic perspective. The researcher hopes that the improvement of the kinds of information will contribute to the development of Islamic banks' practices particularly on social activities and community developments.

Thirdly, the study provides findings that can be used to improve the regulation of Islamic banking. This is important because the researcher assumed that the regulation has received inadequate attention in social activities and community developments by Islamic banks. The obligation to provide social reports will automatically increase the quantity and quality of social activities by Islamic banks.

Fourthly, the findings may encourage accounting regulators to pay attention to social reporting by Islamic banks as well as to improve the accounting standards for Islamic banks in Malaysia.

1.6 THE ORGANIZATION OF DISSERTATION

The structure of the dissertation is as follows:

Chapter 1: Introduction covers the background, motivations of the study, research objective and the contributions of the study.

Chapter 2: Islamic Banking Activities. This chapter explains the basic theory of Islamic banking and current practices particularly on the social activities and community development as the main function of Islamic banks. This chapter focuses on the social roles of Islamic banks that affect their reporting model as a form of accountability to their stakeholders.