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**Islam, Accounting and Finance:
Challenges and Opportunities in the New Decade**

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Department of Accounting,
Kulliyah of Economics and Management Sciences,
International Islamic University Malaysia.

SESSION 4 A

Theme: Islamic Finance

Chairperson: **Prof. Dr. Maliah Sulaiman**

Time: 11.00 am – 01.00 pm

Title	Presenter(s)/Author(s)
1. An Analysis of Credit Risk Practices of Islamic Banks Operating in Pakistan	Azam Ali & Mazhar Khan
2. Global Financial Crises: An Exploratory Conceptual Survey of Selected Literatures From An Islamic Perspective	Dzuljastri Abd. Razak & Mustafa Omar Mohammed
3. Efficiency of Islamic and Conventional Commercial Banks in Malaysia: Corporate Governance Determinants	Suraya Ahmad & Abdul Rahim Abdul Rahman
4. Islamic Letter of Credit (LC-i) In Malaysia: The UCP 600 and Its Shariah Issues	Sharifah Faigah Syed Alwi, Uzaimah Ibrahim & Mohd Fuad Sawari

Venue: Auditorium

SESSION 4 B

Theme: Financial Accounting

Chairperson: **Dr. Nazli Anum Mohd Ghazali**

Time: 11.00 am – 01.00 pm

Title	Presenter(s)/Author(s)
1. The Extent of Information Disclosed in the Practice of Islamic Banking Annual Reports in Malaysia	Nurul Huda Abdul Majid, Kamarun Nisham Taufil Mohd & Abdul Ghafar Ismail
2. An Examination of Social Disclosure by Islamic Banks in Indonesia	Surya Raharja
3. Corporate Social Responsibility Reporting: A Comparison Between Shariah and Non-Shariah Approved Firms in Malaysia	Dalilawati Zainal, Norhayah Zulkifli & Zakiah Saleh
4. Fraudulent Financial Reporting in Malaysia: A Basic Analysis	Sherliza Puat Nelson

Venue: Boeing Room

AN EXAMINATION OF SOCIAL DISCLOSURES BY ISLAMIC BANKS IN INDONESIA

Surya Raharja

Abstract

Islamic banks in Indonesia have grown rapidly in the last fifteen years. These banks operate based on guiding principles called *Sharia*. It will always be embedded social dimension in sharia principles. This research aims to examine in what extent Islamic bank in Indonesia disclose their social activities. Population of this research is Indonesian Islamic Banks in 2009. The examination use disclosure index that have been developed by. Using this index, content analysis is undertaken to measure the volume of social disclosures. The results shows Islamic bank in Indonesia have low level of social disclosure. Islamic banks do not disclose information about activities that may attract criticism, such as unlawful (*haram*) transactions on the other hand they provide more disclosures regarding their charitable activities and their involvement in society.

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Introduction

Islamic banks in Indonesia have grown rapidly in the last fifteen years. Central bank data reveal that assets of the Indonesian sharia banking industry has risen more than 35 times from Rp 1.79 trillion in 2000 to Rp 66.089 trillion at the end of 2009, with an impressive average growth of 53.32 percent per year over the past eight years (The Jakarta Post, 2010). It seems there is a long time lag between standards and the industry. Since the first Islamic bank operated on May 1, 1992 there was not Islamic accounting standard for ten years until first Islamic accounting standard in 2002, then the next standard is in 2007.

In establishing accounting theory and standard, it has been widely acknowledge the concept of reconstruction or inductive method. This method is used in formulating islamic accounting standard indonesia. On the other hand, a reverse of the method named normative (deductive), a method to build theory and setting standard based on 'a should be' norms/ principles. The first method used most in Islamic accounting today, including the most influenced islamic financial insttitution organization called AAOIFI.

It is beyond scope of this paper to confrontate both of the methods, both method have strengths and shortcomings. According to AAOIFI(2003) in Yaya et.al. (2009), the way of inductive approach works is using western accounting objectives that conform with islamic bussiness organization and removing the parts of the objective which is breaking islamic laws. As a result there are two paradigms in Islamic Bank financial statement: capitalism and Islam. Basically social value is not a principle in capitalism, it is a part of fairness principle in Islam. The shortcomings of this approach are islamic values particularly social values not accommodated yet. Even tough standards made by AAOIFI based on capitalism but still in a theorithical stage of development they can be used as starting point that may help lead to an improved set of disclosure criteria that can be used by an Islamic Bank. (Harahap, 2003).

Disclosure dan Social Reporting

In accounting theory there are two categories of disclosure, mandatory and voluntary. Mandatory disclosures are items that companies must disclose because of statutory regulations (Cooke, 1992) therefore, it is the minimum level of information to be disclosed in the annual

reports. Voluntary disclosure is disclosure that not mandated (Cooke, 1992), thus it constitutes information additional to statutory requirements. Usually, a company voluntarily discloses information to assure users that it is a good company. The emergence of these disclosures is caused by the inability of capitalistic financial reporting to meet the needs of information for its stakeholders. The shortcomings of the capitalistic accounting system in establishing fairness principles among company stakeholders, promote the immersion of alternative reporting such like *value added accounting*, *socio-economics accounting*, *environmental accounting* and others (Harahap, 2003).

Many theories have been developed in the social reporting attempting to answer the question of why a company disclose social information, whereas generally social information are not mandatory to disclose. Research models in social reporting also directed to whom information disclosure addressed considering that there are many users that have different degree of interest (Maali et. al,2006). According to Campbell (2000) in Maali et. al, (2006) in practice it is difficult to determine what should be the appropriate form and content of social reporting. The problem lies not in theory but there is in the the nature of responsibility itself. In western societies codes of ethics are often considered to be relativistic, values that may be received by individuals or groups but may not be accepted by other individuals or groups (Lewis and Unerman, 1999 in Maali et. al, 2006). And there is no agreement to determine who is considered valid ethics. This responsibility concept change from time to time and vary from place to place, hence it difficult to determine what should be the appropriate form and content of social reporting.

Islam and Social Values

The west view that considers the code of ethics is relativistic, it is different from the view of Islam. Islam considers social responsibility both as individuals and companies must comply with the Qur'an and Sunnah. From Islamic point of view all banks operate based on guiding principles called *Sharia*. *Sharia* is the Islamic law of human conduct, which regulates all matters of the lives of Muslims. *Therefore*, it will always be embedded social dimension in sharia principles. And the objective of accounting theory must be conformed with the objective of Islamic Economy that is a fair wealth distribution for ummah (Triyuwono dan As'udi, 2001). Therefore Islam provide facilities to reach this fair wealth distribution using zakah, infaq and

sodaqoh system and also non interest system. These facilities are reflected in mandatory financial statement which are Statement of Sources and Uses of Zakah, and Quard Hasan. Thus financial report should contain social value that must be diclosed to stakeholders. According to Hameed (2000) in Triyuwono dan As'udi (2001) the objectives of Islamic accounting are:

1. As the basis for the calculation of zakah
2. Providing a basis for profit sharing, wealth distribution and disclosure of events and values
3. To ensure that the business is in Islamic nature and the results (profits) not harming society

With these characteristics then it is reasonable if the social values reflected and appears in the financial statements, including disclosure.

Most islamic accounting and accountability researches have not directed to social disclosure concepts. According to Maali, Casson dan Napier (2006), all the prior research has been concerned with overall reporting of Islamic businesses, with exception of the model of social reporting developed by Haniffa (2001) and not specifically with social reporting. In Indonesia aside from Harahap (2003) it is hardly to find published research that investigated social disclosure in islamic banking In indonesia. Using indepth analysis on Bank Muamalat Indonesia, Harahap (2003) found the level and extent of disclosure in the bank annual report place more emphasis on general standards and regulatory standards rather than specific Islamic accounting standards.

This paper aims to obtain empirical evidence of the extent of which Islamic banks in Indonesia disclose social values based on the objective of Islamic financial reporting. It will also evaluate in what specific areas of social disclosure mostly done by Indonesian Islamic Banks.

Methodology

This paper is the result of qualitative research. In order to obtain empirical evidence of the extent of annual reports disclose social values based on the objective of Islamic financial reporting, a similar methodology employed as that used in previous studies by Maali,

Casson & Napier (2006) and Abdeldayem (2009). Both of those researchers used social disclosure index developed by Maali, Casson & Napier (2006).

There are six full flagged Islamic banks. They are Bank Muamalat Indonesia, Bank Syariah Mandiri, Bank Mega Syariah, Bank BRI Syariah, Bank Bukopin Syariah and Bank Panin Syariah. Data obtained by downloading annual report from the website. Bank Panin Syariah was excluded because it started operation in the end of 2009. And BRI syariah also excluded because since 2008 it does not publish its annual report, hence four Islamic banks were investigated.

Social disclosure was measured using a disclosure index approach. A checklist instrument that reflects the criteria for identifying the disclosure as a social disclosure are prepared by the nine categories as shown in table 1. The table was designed to codify the qualitative information contained in the annual report. The nine categories show 100% coverage of social disclosure.

To measure and compare the quantity of social disclosures among the banks studied, a content analysis was also undertaken. Content analysis studies in the social reporting literature have adopted the number of words, sentences and pages to measure the volume of disclosure. Hackston and Milne (1996) recommended that sentences overcome the problems of allocating a portion of a page and also removing the need to account for the number of words. Items that are revealed given the numbers 1 and items that are not disclosed given the number 0. While items that are not detailed or not clear in the disclosure of which was given 0.5.

Table 1

Maali, Casson & Napier (2006) Disclosure Index

Area	Items to be disclosed	AAOIFI	Comments
Sharia opinion Unlawful (haram) transactions	Report of Sharia Supervisory Board	Required	
	Nature of unlawful transactions	Required	
	Reasons for undertaking such transactions	Not required	
	The Sharia Board's view about the necessity of these transactions	Not required	
	The amount of revenue or expenses from these transactions	Required	
	How the bank disposed, or intends to dispose, of such revenues	Required	
Zakah (for banks required to pay it)	Statement of sources and uses of Zakah	Required	The statement required by AAOIFI includes Zakah and charity together
	The balance of the Zakah fund, and reasons for non-distribution	Required	
	Sharia Board attestation regarding the computation and distribution of the funds	Not required	
Zakah (for banks not required to pay it)	The amount due in respect of shares and deposits	Required	
	The Sharia Board's opinion regarding validity of computation	Required	
Quard Hassan	Sources of funds allocated to Quard	Required	
	The amounts given to beneficiaries	Required	
	The social purposes for which the funds were given	Required	
	The policy of the bank in providing such loans	Not required	
	The policy of dealing with insolvent beneficiaries	Not required	
Charitable and social activities	The nature of charitable and social activities financed	Required	Required by AAOIFI as part of Zakah statement
	The amount spent on these activities	Required	
	The sources of funds used to finance these activities	Required	
Employees	The policy on wages and other remuneration	Not required	
	The policy on education and training of employees	Not required	
	The policy of equal opportunities	Not required	
	The policy on the working environment	Not required	
Late repayments and insolvent clients	The policy in dealing with insolvent clients	[See comment]	Required by AAOIFI only for Murabaha financing, and not other modes of finance
	The amount charged as late penalty, if any		
	The Sharia Board's opinion regarding the permissibility of imposing additional charges (such as late penalties)		
Environment	The amount and nature of any donations or activities undertaken to protect the environment	Not required	
	The projects financed by the bank that may lead to harming the environment	Not required	
Other aspects of community involvement	The bank's role in economic development	Not required	
	The bank's role in addressing social problems	Not required	

Source: Abdeldayem (2009)

Analysis and Discussion of Results

The coverage level of disclosure for four banks is not much different. It is between 28.57%-35.71%. The results from content analysis that there are significant different in number of sentences the lowest is 12 sentences and the highest is 30. It depicts the quantity of social disclosures among the bank studied. The category that the almost all banks disclose is employee, environment and other aspects of community involvement.

Bank	level of disclosure %	number of sentences
Bank Muamalat Indonesia	32.14%	30
Bank Syariah Mandiri	35.71%	23
Bank Syariah Bukopin	28.57%	16
Bank Syariah Mega Indonesia	28.57%	12

The entire banks have statement from Sharia Supervisory Board, it shows whether the bank has complied with Islamic principles or not. However none of them disclose nature of lawful transaction, reason for undertaking such transaction and Sharia board's view about the necessity of this transaction. It confirms the previous research by Maali, Casson & Napier, 2006) that Islamic banks do not disclose information about activities that may attract criticism.

Category	Banks disclosing	
	Number	%
Sharia opinion	4	100
Unlawful transactions	0	0
Zakah	2	50
Quard Hassan	2	50
Charitable and social activities	2	50
Employees	4	100
Late repayments and insolvent clients	0	0
Environment	3	75
Other aspects of community involvement	4	100

Statement of sources and uses of Zakah and also Qardhul hasan is required by PSAK Syariah (Islamic accounting standard) no 101. There are two banks, Bank Muamalat Indonesia and Bank Syariah Bukopin that do not prepare the both statements. In their financial statement

notes says that the Bank does not prepare a report of sources and uses of zakah fund, infaq as well as shadaqah and report of sources from Qardhul hasan fund use because the Bank is not directly involved in the management of the zakah fund, infaq, shadaqah and Qardhul Hasan fund distribution. It's contradicted with the standard. Even in paragraph 14 mentioned that if the entities have not fully implemented sharia social function, the Islamic entity must remain present Statement of sources and uses of Zakah and also Qardhul Hasan.

Conclusion

The result shows similarity with the two previous researches from Maali et.al (2006) and Abdeldayem (2009). Islamic banks do not disclose information about activities that may attract criticism, such as unlawful (*haram*) transactions. Islamic banks probably avoid issues affecting their Islamic image, on the other hand they provide more disclosures regarding their charitable activities and their involvement in society. Thus, social disclosures are used by the banks to construct a positive Islamic image. God and the Islamic community require Islamic banks to disclose all information deemed important from the Islamic perspective for people in the societies where they operate, and not only information that would help in constructing a beautiful Islamic image (Maali, Casson & Napier, 2006). This research also found two banks that do not present Statement of sources and uses of Zakah and also Qardhul hasan is required by PSAK Syariah (Islamic accounting standard) no 101. It contradicted with standard and the objective of accounting theory.

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