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Social Reporting by Islamic Banks

The last thirty years have witnessed the appearance and rapid expansion of Islamic banking both inside and outside the Islamic world. Islamic banks provide financial products that do not violate Sharia, the Islamic law of human conduct. The Islamic principles upon which the banks claim to operate give an important role to social issues. Applying these principles, we develop a benchmark set of social disclosures appropriate to Islamic banks. These are then compared, using a disclosure index approach, the actual social disclosures contained in the annual reports of twenty-nine Islamic banks (located in sixteen countries) to this benchmark. In addition, content analysis is undertaken to measure the volume of social disclosures. Our analysis suggests that social reporting by Islamic banks falls significantly short of our expectations. The results of the analysis also suggest that banks required to pay the Islamic religious tax Zakah provide more social disclosures than banks not subject to Zakah.

Key words: Islamic banks; Islamic values; Social reporting; Zakah.

Studies of accounting and accountability from an Islamic perspective have been emerging over the last 25 years. Scholars of Islamic accounting, such Gambling and Karim (1986, 1991), Adnan and Gaffikin (1997), Alam (1998), Baydoun and Willett (1997, 2000), Suliman (2000) and Lewis (2001) have adopted an ethical normative approach to develop general accounting theories dealing with financial reporting by Islamic business entities. However, these studies tend not to reflect the political, economic and regulatory situation, and other forces that affect reporting by Islamic businesses. In addition, with exception of the model of social reporting developed by Haniffa (2001), all the prior research has been concerned with overall reporting of Islamic businesses, and not specifically with social reporting.

Islamic societies have become affected, and in some cases dominated, by Western cultural values. This makes it difficult for business enterprises operating in Islamic countries (even those where a full Islamic system applies, such as Sudan and Iran) to apply the accounting and reporting recommendations of the normative studies referred to above. This is likely to continue, even though Western financial and social reporting frameworks may not be suitable for Islamic enterprises. The
significance of this problem has been highlighted by the emergence of a new type of enterprise that aims to abide by Islamic principles and thus serve the ethical needs of Islamic societies: Islamic banks.

In addition to their role in providing investment and financing activities for Muslims who are keen to adhere to Islamic law in their business transactions, Islamic banks offer their clients a variety of financial products that do not violate Sharia. As well as following normal bank accounting and reporting practices, an Islamic bank will put into effect practices that are based on the rulings of its Sharia Supervisory Board. Recently, many Islamic banks have adopted the recommendations of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), which was established in 1990 to set accounting standards (AAOIFI, 1999) for Islamic financial institutions.

Islamic banks have been described as having ‘a social face’ (Mashhour, 1996, p. 33). This is acknowledged formally by many banks: ‘Social activities are emphasized in Islamic banks’ articles of association among their objectives and functions’ (El-Ashker, 1987, p. 45). The claimed importance of the social dimension provides us with an opportunity to explore the nature and extent of social reporting by Islamic banks. Here, we develop a benchmark, based on an Islamic perspective of accountability, social justice and ownership, for social disclosures that we would expect Islamic banks to provide. A secondary objective is to examine the actual social reporting practices of Islamic banks, and compare our empirical findings with that benchmark.

### ISLAMIC BANKING: THEORIES AND PRACTICES

We define Islamic banks as those banks that claim to follow Islamic Sharia in their business transactions. Sharia requires transactions to be lawful (halal) and prohibits transactions involving interest and those involving speculation. It also requires Muslims to pay the religious tax Zakah. Islam’s strict ban on interest has social roots. Mirza and Baydoun (2000, p. 36) argue that Riba (usury) violates the principle of social justice, in that it rewards people who neither make an effort nor participate in the risks of the projects financed. Interest-based transactions allow lenders to receive the advantages associated with lending their money, while avoiding the risks and losses attached to ownership. Gambling and Karim (1991, p. 34) refer to this as ‘unfair trading’. Talip and Phay (1998, p. 65) suggest that the main reason for the ban on Riba is to enforce the spirit of brotherhood between Muslims.

Rather than dealing in interest, Islamic banks use forms of financial instruments, both in mobilizing funds for their operations and in providing finance for their clients, that comply with the principles and rules of Sharia (Archer and

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1 Sharia is the Islamic law of human conduct, which regulates all matters of the lives of Muslims. It is based on God’s holy word in the Qur’an, the deeds and sayings of the prophet Mohammed (Sunah), and the consensus of Islamic religious scholars. In this article, quotations from the Qur’an are taken from the translation of A. Ali (1946) and references to the Sunah are taken from M. Ali (1961).
Karim, 2001, p. 1). Islamic banks obtain funds from depositors through *Mudaraba* contracts. In their original form, these contracts involved one party contributing capital to a venture while the other party contributed labour. The two parties would share the profits generated by the contract according to pre-agreed percentages, but in case of loss the capital provider would bear all financial losses up to the amount invested, while the other party would receive no return for his/her work. In their current form, depositors place their funds with the bank, and the bank invests these funds, with profits being divided between the bank and the depositors according to a predetermined ratio. In the event of loss, the depositors bear the losses and the bank receives nothing for its efforts.

The majority of Islamic scholars consider it permissible to charge higher prices for goods if payment is deferred. Islamic banks have developed a range of ‘mark-up’ instruments, the main one being *Murabaha*. This dominates the activities of Islamic banks to the extent that in some banks it reaches over 90 per cent of financing activities (Hassanien, 1996, p. 13). In its current form (Hmoud, 1998), the client specifies the goods he/she wants to acquire (and sometimes nominates a particular supplier), and the bank purchases the goods from the supplier at their normal price for cash and resells them to the client at a higher price, the total amount due often being paid by instalments.\(^2\) Other mark-up instruments are *Ijarah* and *Salam*.\(^3\) Islamic banks also finance customers through profit/loss-sharing instruments such as *Mudaraba* and *Musharaka* (a form of partnership). Islamic banks undertake other activities provided by conventional banks such as letters of credit, letters of guarantee and current accounts. However, the main condition is that such transactions should not violate *Sharia*, for example by involving interest.

To make sure that the religious expectations of those who deal with Islamic banks have been met, Islamic banks appoint a religious auditor (Daoud, 1996). This may be a single adviser, who is usually referred to as the *Sharia* consultant, or more commonly takes take the form of a ‘*Sharia* Supervisory Board’. *Sharia* Supervisory Boards are in-house religious advisers. They issue a report to the users of financial statements certifying that the bank has adhered to Islamic principles’ (Karim, 1990, p. 34). The responsibilities of the *Sharia* Supervisory Board include *ex ante* and *ex post* auditing of transactions, the calculation and payment of *Zakah*, and advising the bank on its accounting polices (Karim, 1990, p. 35). This board provides the necessary assurance for those who deal with Islamic

\(^2\) *Murabaha* financing still attracts strong resistance from some Islamic scholars, who claim that it violates Islamic principles, in particular because it is similar to interest-based transactions; for more discussion see Al-Abadi (1988), Al-Azzizi (2000).

\(^3\) *Ijara* and *Ijarah wa Iqtina* are similar in some aspects to operating and finance leases. One of the main differences relates to maintenance, where non-routine maintenance is the responsibility of the lessor according to Islamic principles (Western finance leases normally impose such maintenance responsibilities on the lessee). See Zaid (1996a) for more details. A *Salam* sale is a forward sale contract, whereby the seller receives immediate payment and undertakes to deliver well-described goods in the future. See Zaid (1996b) for more details.

\(^4\) In this case, the bank provides funds to an agent (rather than depositors providing funds to the bank) who invests the money, on the same basis as the *Mudaraba* contract discussed above.
banks that their religious expectations have been met. The existence of such assurance may reduce the necessity for very detailed disclosure of many issues.

The early Islamic banks, such as The Farmers’ Credit Union (established in Pakistan in the late 1950s) and the Mit Ghamer Savings Bank (established in Egypt in 1963), were based on social initiatives to achieve social objectives. A study by Mashhour (1996) revealed that the legislative acts or the establishment contracts of many of the early Islamic banks (such as Dubai Islamic Bank 1975, Faisal Islamic Banks in Egypt and Sudan in 1977, and Jordan Islamic Bank in 1978), contained articles requiring the bank to undertake social activities. For example, the first objective mentioned in the Act establishing the Sudanese Faisal Bank in 1977 stated that the bank ‘works according to Islamic principles to support the development of society’. The Act that originally regulated Jordan Islamic Bank in 1978\(^5\) set the objective of the bank as ‘aiming to meet the economic and social needs in the field of banking service’. The Act also contained a distinct section about the social services of the bank. More recent acts regulating Islamic banks have contained similar statements about the banks’ social role (for example, Iraqi Islamic Bank’s articles of association in 1993).

Why are Islamic banks (more perhaps than other businesses) expected to undertake such an important social function? The Islamic banks emerged after a long period of decline in financial activities based on Islamic principles. During the period when Islamic banking transactions were not available, Islamic charitable organizations were active and strong. This has led people in countries where Islam is the predominant religion to perceive any Islamic organization as a charity. This implies that people will have high social expectations of Islamic banks.\(^6\) In addition, Al-Mograbi (1996) has argued that Islamic banks fill two very important positions in the community: religious and financial. On the religious side, Islamic banks take responsibility for complying with the Islamic way, thus setting an example for people in the community who observe their activities. On the financial side, the banks’ control of large funds and revenues helps them to undertake a social role. However, despite the potential importance of the social role, a study of thirty-two Islamic banks by a group of researchers from the International Institute of Islamic Thoughts (1996) found that economic objectives overrode the social objectives of these banks. The study also concluded that economic criteria had priority over social criteria when evaluating investment opportunities. However, the same study revealed that the social roles were very important for Islamic banks, and the majority of the banks in the sample undertook social activities such as \textit{Zakah}.

Islamic banks, therefore, are seen by customers, depositors and the broader community as having a social as well as an economic role, and this is often

\(^5\) This Act was repealed in 2000. Islamic banks in Jordan are now regulated under a section of the general Banking Act (number 28 for the year 2000). The new Act specifically mentions the social role of the Islamic banks.

\(^6\) This argument draws on an interview on 24 October 2002 in Amman between the first author and Mr Ibrahim Abu-Samra, head of the research department of Jordan Islamic Bank and the person responsible for designing the bank’s annual reports.
acknowledged in the official documents establishing the banks. Even if, in practice, the economic role may dominate the social role, it would be reasonable to expect that Islamic banks would report explicitly to stakeholders on how they have discharged this social role. Hence, we would expect Islamic banks to reflect a high level of social reporting in their annual statements.

SOCIAL REPORTING—AN ISLAMIC PERSPECTIVE

Many theories have been developed in the social reporting (SR) literature trying to answer the question of why firms disclose social information, where such disclosures are not enshrined in legislation (Gray et al., 1995a, p. 47). Theories also consider for whom social information is provided, since there are many potential users of information disclosed by firms, with varying degrees of importance for the firm. These theories of social reporting have offered a range of explanations and justifications for social disclosures, but they have not provided a conclusive answer to either the question of why the actual social disclosures observed in practice have been made or the question of what should be the appropriate form and content of social reporting. Those who have written on SR agree that it is a phenomenon for which it is difficult to find explanations (Campbell, 2000, p. 81). Perhaps the problem lies not in theories but rather in the nature of responsibility itself. In Western societies, where theories of SR have developed, ethical codes are often (though not universally—Lewis and Unerman, 1999) seen to be relativistic: A given practice may be accepted by an individual or group of people but not acceptable to others, and there is no agreed way of determining whose ethical views are valid. As argued by Gray et al. (1987), identifying the responsibility of any organization is problematic because responsibility changes over time and from place to place and there is no agreed answer to the question of who determines what responsibilities exist.

On the other hand, in Islam, the rights and obligations of individuals and organizations with respect to others are clearly defined by religion, and are neither imposed by secular law that is exposed to change, nor subject to personal views. From an Islamic standpoint, this is considered to make Islam a stronger and more effective basis for ethical values. Despite the presence of many schools of thought in Islam, there is agreement on basic matters of principle (Hamid et al., 1993, p. 136). Responsibilities of members of society to each other are well defined, do not change over time and are not affected by different theoretical frameworks. This makes definitions of responsibilities stable without being static, and hence

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7 Gray and his collaborators tend to distinguish between social reporting and environmental reporting. In this article, we have treated environmental disclosures as a sub-set of social disclosures.

8 Examples of these theories are the normative accountability approach (e.g., Gray, 2001; Gray et al., 1987, 1988, 1996, 2001), the decision usefulness approach (e.g., Buzby and Falk, 1979; Rockness and Williams, 1988; Epstein and Freedman, 1994; Deegan and Rankin 1997), agency and positive accounting theories (e.g., Belkaoui and Karpik, 1989; Ness and Mirza, 1991), stakeholder theory (e.g., Ullmann, 1985; Roberts, 1992), legitimacy theory (e.g., Guthrie and Parker, 1989; Campbell, 2000), and political economy theory (e.g., Woodward et al., 2001).
potentially irrelevant in other places or times. Islam claims to be a religion relevant for all times and places.

In addition, in the Islamic context, the social responsibilities of individuals that are derived from the word of God (contained in the Qur’an) and from his prophet Mohammed’s deeds and sayings (the Sunah) also apply to firms. Similarly, the main purpose of an Islamic business is to satisfy the will of God, through following the Qur’an and Sunah. Islam considers work to be part of the worship of God. It is legitimate for a business to aim to achieve profits, but this goal should be pursued according to Sharia. Since Sharia defines the norms of human conduct, and how business has to deal with its external environment, businesses claiming to comply with Sharia should be clearer about their roles in society.

Social reporting takes place within a framework of social relations. Fundamental to an Islamic perspective on social reporting is an understanding of the concepts of accountability, social justice and ownership that are central to social relations. This understanding will then allow us to develop a benchmark for the content of social disclosures that businesses claiming to comply with Sharia could reasonably be expected to make.

**Accountability**

Gray (2001, p. 11) has defined accountability as ‘identifying what one is responsible for and then providing information about that responsibility to those who have rights to that information’. In Western models of accountability, firms (seen either as entities in their own right or as represented by managers) are accountable to their stakeholders; a major theoretical issue is identifying who are the relevant stakeholders who have rights to information, and how far such rights extend. In these models, the responsibility and therefore the accountability of companies are not considered to extend beyond human society, and therefore such theories do not envisage any accountability to God (Haniffa, 2001, p. 9).

From the Islamic perspective, the perceived relationship of individuals and firms with God affects the concept of accountability. This flows from the basic Islamic concept of Tawhid (the unity of God). According to this concept, the Creator is one, and everything originates from this one source. All created things are thus elements of a single set and the whole world is one unit with a single goal, which is God’s will. The concept of the unity of God implies total submission to God’s will and following the religious requirements in all aspects of life. Each Muslim is thus responsible to God for everything that he or she does. Baydoun and Willett (1997, p. 6) have argued that the concept of the unity of God gives rise to a different and broader concept of accountability than that implied by Western models. In the Islamic framework, all people, and businesses, are accountable to God on the Day of Judgment for their actions during their lives: ‘God takes careful account of everything’ (Qur’an, 4:86). The notion that everyone is accountable to God provides a different dimension to the concept of accountability beyond what has been reflected in Western theories of social reporting. Muslims undertake social activities not for pure financial reward, but rather to gain God’s praise and avoid God’s anger on the Day of Judgment: ‘Then shall anyone who does an
atom’s weight of good see it, and anyone who does an atom’s weight of evil see it’
(Qur’an, 99:7, 8).

The relationships of Muslims to each other and to the Umma (which refers to
Islamic society) in general are emphasized in the Qur’an and Sunah. Submission
to the will of God thus includes recognizing the rights of others, and dealing
with society justly. Thus, accountability to God includes accountability to society.
‘Business enterprises, both managers and providers of capital, are accountable for
their actions both inside and outside their firms, accountability in this context
means accountability to the community (Umma)’ (Lewis, 2001, p. 113).

Social Responsibility and Justice
Islam stresses the concept of social responsibility. The term ‘brotherhood’
(Akhowa) is widely used in Islamic societies. All Muslims are considered to be
brothers and should take care of each other, and no cheating or exploitation is
allowed, whatever the reasons. Muslims are supposed to take care of others in
society—the prophet Mohammed said: ‘the Muslims in their mercy towards each
other are like a body, if a single part of it complains the other parts would be
affected’ (Sahih Al-Bukhari—Ali, 1961). The prohibition of Riba (usury), the
requirement to pay Zakah and the provision of Quard Hassan (interest-free
loans) are clear examples of the Islamic emphasis on social justice.

Islam also stresses that people should be dealt with justly: ‘God commands
justice, the doing of good’ (Qur’an, 16:90). In this context, justice refers to being
fair with everyone. Muslims are prohibited from engaging in any activity that
includes any kind of exploitation, or leads to injustice or harm to anyone. As
Ahmad (1995, p. 82) notes, ‘Justice forms the core of the Quranic injunctions’.
For Islamic businesses, the requirement to deal justly encompasses all dealings with
employees, customers and all members of the society in which these businesses
operate.

Ownership and Trust
God is the ultimate owner of everything. God has appointed humanity his vice-
regent on earth and has entrusted humanity with stewardship of God’s possession
(Lewis, 2001, p. 110). Islam recognizes private ownership; everyone has the right
to own properties, but the ownership is not absolute. A person holds property in
trust for God, and should use this property according to God’s will. The Qur’an
acknowledges the right of ownership over wealth that has come rightfully into a
person’s possession, and this recognition extends equally to public as well as pri-
vate ownership. In both cases, however, a person holds a delegated right of owner-
ship and hence wields a restricted authority over wealth in his or her possession
(Ahmad, 1995, pp. 44–45). This trustee-ownership principle implies that owner-
ship should be exercised for the benefit of society as well as for the benefit of the
owner: ‘if the choice is between an ethical-moral consideration and profit, the
former prevails over the latter, other things being equal’ (Bassiouni, 1988).

This argument adds a new dimension to accountability: Islam respects private
ownership, but ownership is not absolute. God’s commandments and the benefits
of society should be given priority when dealing with properties. The owner is responsible for using the available resources according to the will of God and to the benefit of society.

**Disclosure in an Islamic Context**

For pious Muslims, following the requirements of *Sharia* is central to life. In an Islamic context, the main objective of corporate reporting is to allow Islamic enterprises to show their compliance with *Sharia* (Baydoun and Willett, 1997, p. 6). Other objectives of corporate reporting may include those known in the Western model, such as assisting decision makers in making economic decisions, but from an Islamic perspective, these are secondary objectives. This view of the primary objective is adopted by AAOIFI when setting out its statement of objectives of financial accounting for Islamic banks and financial institutions. The implication of this position is that Islamic businesses should disclose all information necessary to advise the *Umma* (Islamic community) about their operations, even if such information would work against the firm itself. The concept of disclosure is thus related to the concept of accountability: In an Islamic context, the *Umma* has the right to know how organizations that are part of the *Umma* affect its well-being.

The duty to disclose the truth is a very important issue in the Islamic context, and this duty applies to businesses as much as to individuals. This duty is emphasized in the *Qur’an*: ‘and cover not truth with falsehood, nor conceal the truth when you know’ (2:42). ‘Six verses of the *Qur’an* refer to relevance; one meaning of the relevance referred to is disclosure of all facts’ (Askary and Clarke, 1997, p. 142). For Islam, God is omniscient. God says ‘I know what ye reveal and what ye hide’ (*Qur’an*, 4:33) and also ‘he [God] knows what is manifest and what is hidden’ (*Qur’an*, 87:7). God does not need humans or businesses to show God what they are doing because God already knows what people have done, are doing and will do in the future. However, as accountability to God implies accountability to society, the duty to disclose the truth is owed to the *Umma* as well as to God. The requirement for Muslims to uncover the truth is intended to help the community to know the effect of a person or a business on its wellbeing. Muslims are responsible for their actions and must take into account this responsibility towards the society in which they live because their actions affect society (Al-Mograbi, 1996, p. 20). Islamic businesses are required, as is the case for individuals, to undertake charitable activities and to help the poor and people in need. This is emphasized in many of the Quranic verses and the *Sunah*. God says ‘of their goods take alms that so thou mightest purify and sanctify them’ (*Qur’an*, 9:103). The requirement to pay *Zakah* is a clear example of such obligation (the *Qur’an* specifies eight uses for *Zakah*). The information provided by Islamic business enterprises, in addition to showing compliance with *Sharia*, should therefore help Muslims in performing their religious duties, especially the payment of *Zakah*.

The implication of this discussion is that there are three broad objectives that can be used as the basis for identifying the social disclosures of Islamic business enterprises:
1. To show compliance with Islamic principles, in particular dealing justly with different parties.
2. To show how the operations of the business have affected the wellbeing of the Islamic community.
3. To help Muslims to perform their religious duties.

Such objectives will now be used as the basis for proposing a benchmark for social reporting by Islamic banks. Our benchmark is based on the broader concept of accountability that Islamic banks accept: claiming to follow Islamic principles requires these banks to consider ethical issues differently from banks following Western ways. Our benchmark is pragmatic and takes into account the different secular effects facing Islamic banks. However, this does not prevent them from disclosing our suggested items on a voluntary basis, even if they are not required by regulation.

A Benchmark for Social Disclosures by Islamic Banks

Disclosure of Sharia Supervisory Board Opinion  The users of Islamic banks’ annual reports should be interested in the report of the Sharia Supervisory Board because it shows whether the bank has complied with Islamic principles or not and whether it has dealt justly with different parties. Gambling et al. (1993, p. 198) argue that through the Sharia Supervisory Board, Muslim customers, including depositors and borrowers, obtain assurance that their moral expectations are being fulfilled. As the operations of any single bank will affect the whole of society, whether the bank has practised Islamic principles consistently will affect the wellbeing of Islamic society. Thus, we expect Islamic banks to report the Sharia Supervisory Board’s opinion regarding the bank’s operations.

Unlawful transactions  Islamic banks should not enter into any transaction that violates Islamic principles. However, in some cases the bank may be forced to enter into such transactions. For example, in some countries the bank may have to deposit part of its customers’ deposits in an interest-bearing account at the central bank. Also, the Islamic bank may use hedging or option transactions that are not accepted according to Islamic principles because they contain elements of excessive risk (gharar).

Where a bank has entered into transactions that are inconsistent with Sharia principles, and hence regarded as unlawful (haram) by Islam, the duty of accountability to God and society implies that information about these transactions should be disclosed to the community, to enable the community to assess the extent and materiality of such violations. We consider that the bank should provide information on (a) the nature of these transactions, (b) the reasons for undertaking such transactions, (c) the opinion of the Supervisory Board regarding the necessity of undertaking such activities, (d) the amount of revenue (expenses) earned (paid) in such transactions, and (e) how the bank disposed, or intends to dispose, of such revenues.

Zakah  Although Zakah is obligatory for all Muslims, there is controversy in the Islamic literature as to whether Islamic businesses are obligated to pay this tax, or
whether it is obligatory only for individuals (Shihadheh, 1987, p. 32; Gambling and Karim, 1991, p. 103). However, Islamic banks may be required by law to pay Zakah (as is the case in Saudi Arabia) or the shareholders and/or the depositors may require a bank to pay Zakah on their behalf.

Zakah is a tax based on wealth, but the determination of which assets are subject to Zakah is complex, and the calculation of the Zakah base is thus difficult for businesses required to pay Zakah because they have different kinds of assets and liabilities. Businesses face the same problem even if they are not required to pay Zakah, if they wish to provide information to their shareholders and depositors to help the latter calculate the amount of Zakah due in respect of their investments and deposits. This situation led AAOIFI to issue a standard on the computation of Zakah.

We suggest that those banks required by law or by their shareholders to pay Zakah ought to provide a statement showing the sources and the uses of the Zakah fund. This should make clear any balance of the Zakah fund not yet distributed, and the reasons for the delay in distribution, if the amount is material. It would be appropriate to expect the Sharia Supervisory Board (either in the report of the board or separately) to attest that the amount of Zakah has been properly computed and these funds have been distributed according to God's will.

There is an important difference between our recommendations and the requirements of AAOIFI. Its standards require a statement of ‘Sources and uses of funds in Zakah and charity funds’: Such a statement includes both Zakah, which is obligatory, and charity funds, which are voluntary. It is important to distinguish between what the bank gives as charity on a voluntary basis, and what it gives in compliance with Sharia. Zakah is one of the pillars of Islam; charity is encouraged by Islam, but is not obligatory. The importance of such differentiation is that it assists the users of the annual report to know the amount that the bank has contributed to the wellbeing of society on a voluntary basis.

For these banks not required by law to pay Zakah, it is important for the shareholders and depositors to know how much they should pay as Zakah on their funds invested in the bank. We therefore consider that Islamic banks in this category should disclose the amount due in respect of shares and deposits. AAOIFI standards also require Islamic banks to provide such disclosures.

*Quard Hassan* This is an alternative to interest-bearing loans, which Islamic banks provide to individuals (and exceptionally to commercial clients in difficulty—Khan, 2000, p. 19) for socially beneficial purposes. *Quard Hassan* is one of the social contributions that Islamic banks make to the society in which they operate. It is important for users of annual reports to know about the bank’s performance in this area, to help them to assess whether the bank is undertaking its religious duties and following Islamic principles. Users also need to know whether the bank finances such activity from its own resources or from the depositors’ resources, and whether or not the bank operates a formal scheme whereby depositors may designate funds to be used for *Quard Hassan*. 
Hence banks making Quard Hassan loans should disclose the amounts advanced to beneficiaries during the year, and the purposes for which the loans have been made. They should also disclose the sources from which such loans have been financed: These sources may include the bank’s own funds and depositors’ funds. These two recommended disclosures are covered by AAOIFI standards, which require the bank to prepare a statement called ‘Statement of sources and uses of the Quard funds’. We consider that the bank should also disclose its policy for providing such loans and its policy for dealing with those who are unable to repay their loans.

**Charity and Other Social Activities** In addition to Quard Hassan, Islamic banks should engage in other social activities, such as making charitable donations (mentioned many times in the Qur’an and Sunah). Islamic banks, which usually control large funds, are expected to participate in providing such charitable donations. Islamic society and the stakeholders of the bank should know about the bank’s contribution to the wellbeing of society, by helping the poor and needy, and whether the bank fulfils society’s expectations regarding this issue. We therefore consider that Islamic banks should disclose (a) the nature of charitable and social activities financed by the bank, (b) the amount spent on these charitable and social activities, and (c) the sources of funds used for charity (these may include the bank’s own funds and revenues from sources prohibited by Sharia).

**Employees** Islam’s emphasis on social justice and on just dealing includes relations with employees. The Islamic community needs to know if the bank deals justly with its employees: Exploitation and discrimination are not acceptable, as these are strictly prohibited by the Qur’an and Sunah. In addition, education and training are important as Islam encourages the search for knowledge. Our disclosure benchmarks are consistent with those of Haniffa (2001), and relate to the bank’s policies for payments of wages and bonuses, education and training for employees, equal opportunities, and the working environment. Providing such disclosures would help users in assessing whether the bank violates the Islamic principles regarding its dealings with its employees.

**Late Repayments and Insolvent Clients** Islamic banks, when utilizing mark-up financing arrangements such as Murabaha and Ijara, may face situations in which clients are unable to pay amounts when they fall due. Where the client experiences strained circumstances that lead to insolvency, the Sharia requires the lender to defer or even forgo the collection of the debt: ‘If the debtor is in a difficulty, grant him time till it is easy for him to repay. But if ye remit it by the way of charity, that is best for you if ye only knew’ (Qur’an, 2:280). We would expect users to be interested in how the bank deals with insolvent clients, and whether the bank deals with them in an ethical way, consistent with Islamic principles. We therefore consider that the Islamic bank should disclose (a) the bank’s policy in dealing with insolvent clients, (b) the amounts charged as late penalties, if any, (c) the opinion of the Sharia Supervisory Board regarding whether charging penalties is permissible, and (d) how the bank deals with such penalties (allocation to charity or revenue).
The Environment  Destruction of or damage to the physical environment, if it is considered harmful to an individual or community, is prohibited in Islam (Alam, 1998, p. 75). Banking is unlikely to cause direct harm to the environment in the way that, for example, extractive and nuclear industries might, but Islamic banks are not expected to finance activities that lead to harming the environment, because such projects would harm society. In addition, Islamic banks are able to provide donations to help preserve the environment. Users will require assurance that the activities of Islamic banks affect positively the well-being of Islamic society. We would therefore expect Islamic banks to report the nature and amount of any donations or activities undertaken to protect the environment, and to disclose whether the bank has financed any projects that may lead to environmental harm.

Other Community Involvement Aspects  In addition to their Zakah and charitable activities, Islamic banks are expected to undertake other activities that enhance the wellbeing of the Umma, in which the Islamic bank is allowed to operate and make profits. Thus, Islamic banks should respect the requirements of their community (Al-Mograbi, 1996, p. 42). Because of this, Islamic banks are expected to give priority in their investments to those areas that help in solving the problems of the society, even if this would lead them to sacrifice some of their profits (Mashhoor, 1996, p. 19). Thus, we would expect an Islamic bank to disclose its role in enhancing economic development and addressing social problems (such as housing and literacy) of the societies in which it operates.

The disclosures we would expect are summarized in Table 1. Some of these are requirements of AAOIFI, others have been derived from the social reporting literature.

EMPIRICAL INVESTIGATION

The benchmark set of social disclosures has been derived by applying Islamic principles in an a priori manner. In order to determine the extent to which Islamic banks are disclosing social aspects of their activities that we consider to be particularly relevant to users in the Islamic community, we undertook an exploratory study of social disclosure practices of Islamic banks. The aim was to assess how far and in what specific areas Islamic banks were already making social disclosures. Given that the reporting practices of Islamic banks will depend on institutional factors such as whether banks are required to follow AAOIFI standards and whether they are required to pay Zakah, we tested whether these factors could explain differences in the extent of disclosure. Some disclosure studies (e.g. Nichols et al., 1995; Collett, 2004) used a control group to control for selected variables not of interest to the researcher, though there are problems associated with the use of control groups, such as sample selection bias (Mosley, 1998). A potential control group for the present study would be a sample drawn from conventional banks based in Islamic countries. However, many of the disclosure items in our benchmark, such as Zakah, are unique to Islamic banks, so we would have no reason to expect any such disclosures from a control group. Hence we considered the use of a control group to be unwarranted.
## Table 1

### EXPECTED DISCLOSURES

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<th>Area</th>
<th>Items to be disclosed</th>
<th>AAOIFI</th>
<th>Comments</th>
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<tr>
<td><em>Sharia</em> opinion</td>
<td>Report of <em>Sharia</em> Supervisory Board</td>
<td>Required</td>
<td></td>
</tr>
<tr>
<td>Unlawful (<em>haram</em>) transactions</td>
<td>Nature of unlawful transactions</td>
<td>Required</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Reasons for undertaking such transactions</td>
<td>Not required</td>
<td></td>
</tr>
<tr>
<td></td>
<td>The <em>Sharia</em> Board’s view about the necessity of these transactions</td>
<td>Not required</td>
<td></td>
</tr>
<tr>
<td></td>
<td>The amount of revenue or expenses from these transactions</td>
<td>Required</td>
<td></td>
</tr>
<tr>
<td></td>
<td>How the bank disposed, or intends to dispose, of such revenues</td>
<td>Required</td>
<td></td>
</tr>
<tr>
<td><em>Zakah</em> (for banks required to pay it)</td>
<td>Statement of sources and uses of <em>Zakah</em></td>
<td>Required</td>
<td>The statement required by AAOIFI includes <em>Zakah</em> and charity together</td>
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<td></td>
<td>The balance of the <em>Zakah</em> fund, and reasons for non-distribution</td>
<td>Required</td>
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<td></td>
<td><em>Sharia</em> Board attestation regarding the computation and distribution of the funds</td>
<td>Not required</td>
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<tr>
<td><em>Zakah</em> (for banks not required to pay it)</td>
<td>The amount due in respect of shares and deposits</td>
<td>Required</td>
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</tr>
<tr>
<td></td>
<td>The <em>Sharia</em> Board’s opinion regarding validity of computation</td>
<td>Required</td>
<td></td>
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<td><em>Quard Hassan</em></td>
<td>Sources of funds allocated to <em>Quard</em></td>
<td>Required</td>
<td>Required by AAOIFI standards as a statement</td>
</tr>
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<td></td>
<td>The amounts given to beneficiaries</td>
<td>Required</td>
<td></td>
</tr>
<tr>
<td></td>
<td>The social purposes for which the funds were given</td>
<td>Required</td>
<td></td>
</tr>
<tr>
<td></td>
<td>The policy of the bank in providing such loans</td>
<td>Not required</td>
<td></td>
</tr>
<tr>
<td></td>
<td>The policy of dealing with insolvent beneficiaries</td>
<td>Not required</td>
<td></td>
</tr>
<tr>
<td>Charitable and social activities</td>
<td>The nature of charitable and social activities financed</td>
<td>Required</td>
<td>Required by AAOIFI as part of Zakah statement</td>
</tr>
<tr>
<td>---------------------------------</td>
<td>-----------------------------------------------------</td>
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<tr>
<td></td>
<td>The amount spent on these activities</td>
<td>Required</td>
<td></td>
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<tr>
<td></td>
<td>The sources of funds used to finance these activities</td>
<td>Required</td>
<td></td>
</tr>
<tr>
<td>Employees</td>
<td>The policy on wages and other remuneration</td>
<td>Not required</td>
<td></td>
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<tr>
<td></td>
<td>The policy on education and training of employees</td>
<td>Not required</td>
<td></td>
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<td></td>
<td>The policy of equal opportunities</td>
<td>Not required</td>
<td></td>
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<tr>
<td></td>
<td>The policy on the working environment</td>
<td>Not required</td>
<td></td>
</tr>
<tr>
<td>Late repayments and insolvent clients</td>
<td>The policy in dealing with insolvent clients</td>
<td>[See comment]</td>
<td>Required by AAOIFI only for Murabaha financing, and not other modes of finance</td>
</tr>
<tr>
<td></td>
<td>The amount charged as late penalty, if any</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>The Sharia Board’s opinion regarding the permissibility of imposing additional charges (such as late penalties)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Environment</td>
<td>The amount and nature of any donations or activities undertaken to protect the environment</td>
<td>Not required</td>
<td></td>
</tr>
<tr>
<td></td>
<td>The projects financed by the bank that may lead to harming the environment</td>
<td>Not required</td>
<td></td>
</tr>
<tr>
<td>Other aspects of community involvement</td>
<td>The bank’s role in economic development</td>
<td>Not required</td>
<td></td>
</tr>
<tr>
<td></td>
<td>The bank’s role in addressing social problems</td>
<td>Not required</td>
<td></td>
</tr>
</tbody>
</table>
Sample and Data
The initial population for this study comprised all full-flagged Islamic banks. These were identified from the International Directory of Islamic Banks and Institutions issued by the Institute of Islamic Banking and Insurance in London (IIBI, 2000). This directory identifies over 200 financial institutions around the world offering Islamic banking. In addition, other banks operating in Iran according to Islamic principles, not listed in this directory, were included in the initial population. In total, eighty-eight full-flagged Islamic banks were identified.

Evidence of social reporting was sought through an examination of annual reports. These documents are not the only means by which organizations communicate social information. Banks may produce and use other documents throughout the year containing social information, and may use advertising and their websites to convey social information. However, Gray et al. (1995b) point out that the annual report is not only a document produced regularly to comply with regulatory requirements, it is also central to the organization’s construction of its own external image. We therefore consider only those social disclosures made in annual reports. A letter was sent to all the banks within the population requesting a copy of their annual report for year 2000 (data collection took place in late 2001 and early 2002 so 2000 was considered the latest year for which annual reports would be available). Banks failing to respond after twelve weeks were sent a follow-up letter. Of the thirty-three banks responding to the requests, four were excluded from the analysis, leaving a sample of twenty-nine. A disclosure index based on our expectations as set out in the previous section this paper (as summarized in Table 1) was constructed. There is extensive use of disclosure indexes in the accounting literature (e.g., Chow and Wong-Boren, 1987; Cooke, 1989; Wallace and Naser, 1995; Inchausti, 1997; Depoers, 2000). Many of those authors adopt a decision usefulness approach and their disclosure indexes are weighted according to the perceived relative importance of each item. However, Barrett (1976) has noted that some arbitrariness is clearly inherent in the use of any weighted index. In addition, the decision usefulness approach is not a central concept for this article. For these reasons each item in our disclosure index is given the same weight. Following the approach used by Buzby and Falk (1979) and Inchausti (1997), items specifically disclosed were given a score of 1, items not disclosed were given 0, and items disclosed in ambiguous terms or in a less specific way were given 0.5. Since some items are not applicable to some banks (e.g., some banks are required by law to pay Zakah while others are not), the disclosure index was constructed as a ratio of the actual score to the maximum possible value for each bank (28 for banks required to pay Zakah, otherwise 27).

These are banks that aim to operate on a fully Islamic basis. Many banks now offer ‘Islamic windows’, whereby they are prepared to undertake financing on an Islamic basis for particular clients. However, these banks mainly operate according to standard Western banking practices and are thus not considered to be Islamic banks for the purposes of this research.

Those banks are: Bank Mellat Iran (no report for year 2000), Development Bank of Brunei (no report for year 2000), Islamic Development Bank (non profit seeking bank), Bank Tejarat Iran (incomplete annual report was received).
About half of our expected disclosures are required by AAOIFI, and eleven of the twenty-nine banks studied (38 per cent) claim to follow AAOIFI standards. AAOIFI disclosure requirements stress social aspects in many areas, so an overlap between our disclosure benchmark and the AAOIFI disclosure requirements is to be expected. However, in this study we are not primarily investigating compliance with standards; rather, our main concern is whether Islamic banks disclose relevant information based on the moral responsibility that they accept through their claim to follow Islamic principles.

To measure and compare the quantity of social disclosures among the banks studied, a content analysis was also undertaken. Content analysis has a strong foundation in the social disclosure literature (e.g., Ingram, 1978; Ingram and Frazier, 1980; Freedman and Jaggi, 1982; Guthrie and Parker, 1989; Zéghal and Ahmed, 1990; Gray et al., 1995a; Buhr and Freedman, 2001). A checklist instrument describing the criteria for identifying disclosures as social disclosures that come within the nine categories summarized in Table 1 was designed in order to codify the qualitative information contained in the annual reports. Attempts were made to ensure that each definition was unambiguous and mutually exclusive of others to eliminate any overlapping of interpretations. Content analysis studies in the social reporting literature have adopted the number of words, sentences, and/or pages to measure the volume of disclosure. Williams (1999) observes that there is no overwhelming case in the theoretical literature for preferring any of these units of analysis to the others. Ingram and Frazier (1980, p. 617) advocate the use of number of sentences on the ground that ‘a sentence is easily identified, is less subject to inter judge variations than phrases, classes and themes, and has been evaluated as an appropriate unit in previous research’. In comparing sentences to both words and pages Hackston and Milne (1996, p. 84) suggest that ‘sentences overcome the problems of allocating a portion of a page, whilst also removing the need to account for, or standardize, the number of words’. For these reasons, we chose to analyse the number of sentences.

Results

The disclosure ratios and the results of the content analysis are set out in Table 2. This shows clearly that the extent of social disclosure by Islamic banks falls far short of our benchmark. The mean level of disclosure compared to our benchmark was 13.3 per cent. This mean conceals considerable variation in the extent of disclosure (the standard deviation was 9.0 per cent and the distribution is positively skewed). Those banks coming closest to meeting our benchmark were Jordan Islamic Bank in Jordan, First Islamic Bank in Bahrain and Al-Shamal Islamic bank in Sudan. However, banks such as Arab Albanian Islamic Bank in Albania and Al-Barakah Turkish Finance House disclosed none of the social disclosure items we expected.

The content analysis shows that, on average, Islamic banks provide twenty-five sentences that can be considered as social disclosures according to the categories described in Table 1. Again, the distribution is positively skewed, with a standard deviation of twenty-two sentences. Faisal Islamic Bank, which provides audited
financial statements for *Zakah* funds as part of its annual report, had the largest
volume of social disclosures. Jordan Islamic Bank also provides a large amount of
social disclosures. This is probably due to the emphasis placed on social issues in the
Act that originally regulated this bank, and to the personal initiatives of the bank’s
managers (Maali, 2005). Against this, the Islamic Bank in Albania and Al-Barakah
Turkish Finance House do not provide any social disclosures in our categories
in their annual reports. The other bank failing to provide social disclosures was

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Arab Palestinian Islamic Bank. This bank was affected by the very difficult economic situation in the occupied territories in Palestine in 2000 (the year for which annual reports were analysed), and the bank provided a summarized annual report which only included the audited financial statements.

We have already mentioned that many of our expected social disclosures are required by AAOIFI standards. Eleven of the banks in the sample follow AAOIFI standards. The mean number of sentences relating to social disclosures provided by these banks was 30.1 compared to 21.7 sentences disclosed by banks that do not apply AAOIFI standards. Using the \( t \)-test for the difference of means, the difference is not statistically significant (see Table 3). Because the distribution of number of sentences is significantly skewed, the Mann-Whitney rank sum test was also carried out. The value of the Mann-Whitney \( U \) statistic was not large enough (at a 95 per cent confidence level) to allow us to conclude that the difference between the number of sentences disclosed by banks that claimed to follow and did not claim to follow AAOIFI standards was significant. It is worth mentioning that many of the banks that claim to adopt AAOIFI standards do not in fact comply with the disclosure requirements for items discussed in this paper. For example, these banks in general tend to avoid mentioning the nature and the amount of unlawful (\textit{haram}) transactions: Of the twelve banks that mentioned the disposal of unlawful revenues, only one commented on the nature of these revenues despite the requirement of AAOIFI in this regard. The banks may consider that such disclosure will have an adverse effect on their image. The banks in Sudan, which claim to apply AAOIFI standards according to the Sudanese central bank’s requirements, tend not to provide disclosures about Zakah (as required by AAOIFI) since Zakah has to be paid to government agencies. No bank in our sample discloses its policy for dealing with insolvent clients.

We expected that Islamic banks operating in economic systems that are not fully Islamized systems would provide more social disclosures—as defined by the

<table>
<thead>
<tr>
<th>Item</th>
<th>No.</th>
<th>Number of sentences</th>
<th>( t )-statistic (significance: ( p )-value, two-tailed)</th>
<th>Mann-Whitney ( U ) (significance: ( p )-value, two-tailed)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks following AAOIFI standards</td>
<td>11</td>
<td>30.1 29.0</td>
<td>1.02 (0.32)</td>
<td>56.50 (0.06)</td>
</tr>
<tr>
<td>Banks not following AAOIFI standards</td>
<td>18</td>
<td>21.7 14.0</td>
<td>(0.32)</td>
<td>(0.06)</td>
</tr>
<tr>
<td>Banks operating in full Islamized economy</td>
<td>9</td>
<td>19.3 17.0</td>
<td>−0.92 (0.36)</td>
<td>75.00 (0.48)</td>
</tr>
<tr>
<td>Banks not operating in full Islamized economy</td>
<td>20</td>
<td>27.3 22.5</td>
<td>(0.36)</td>
<td>(0.48)</td>
</tr>
<tr>
<td>Banks required to pay Zakah</td>
<td>10</td>
<td>36.2 29.0</td>
<td>2.19 (0.04)</td>
<td>52.50 (0.05)</td>
</tr>
<tr>
<td>Banks not required to pay Zakah</td>
<td>19</td>
<td>18.9 15.0</td>
<td>(0.04)</td>
<td>(0.05)</td>
</tr>
</tbody>
</table>
categories in Table 1—than banks operating in fully Islamized economies. This is because Islamic banks operating side by side with conventional banks in non-Islamized economies need to demonstrate to the community that they follow Islamic principles with their emphasis on social issues, while banks operating in fully Islamized economies should have nothing to prove. The mean volume of social disclosures provided by banks operating in Islamized economies (Sudan, Iran and Pakistan) is nineteen sentences, while the average for banks operating in non-fully Islamized economies was twenty-seven sentences. However, the difference is again not statistically significant.

Ten of the banks studied are required to pay Zakah, either by law (such as banks in Sudan) or by their articles of association (such as Faisal Islamic Bank in Egypt). Banks required to pay Zakah provide on average thirty-six sentences of social disclosures, while banks not required to pay Zakah disclose on average nineteen sentences. The difference is statistically significant at 95 per cent confidence level. The non-parametric Mann-Whitney rank sum test supports this inference.

Content analysis by category (see Table 4) shows that none of the Islamic banks studied makes disclosures regarding the environment (possibly environmental issues were not seen as relevant by financial institutions), and there were no disclosures relating to the treatment of insolvent clients. The amount and nature of revenue from unlawful transactions are disclosed only by banks following AAOIFI (as a note in the Sharia Supervisory Board’s report), and not all the banks claiming to follow AAOIFI standards disclosed this information in the notes to financial statements. Despite the importance of Quard Hassan for Islam, only two banks provided detailed information and a further two banks made a

<table>
<thead>
<tr>
<th>Table 4</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>SOCIAL DISCLOSURES BY CATEGORY</strong></td>
</tr>
<tr>
<td>Category</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Sharia opinion</td>
</tr>
<tr>
<td>Unlawful (haram) transactions</td>
</tr>
<tr>
<td>Zakah (for 10 banks required to pay it)</td>
</tr>
<tr>
<td>Zakah (for 19 banks not required to pay it)</td>
</tr>
<tr>
<td>Quard Hassan</td>
</tr>
<tr>
<td>Charitable and social activities</td>
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<tr>
<td>Employees</td>
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<tr>
<td>Late repayments and insolvent clients</td>
</tr>
<tr>
<td>Environment</td>
</tr>
<tr>
<td>Other aspects of community involvement</td>
</tr>
</tbody>
</table>
brief statement about this Islamic loan. Although AAOIFI requires Islamic banks to provide a statement of Quard Hassan as part of a full set of financial statements, none of the eleven banks claiming to follow AAOIFI standards did this. Eighteen banks (62 per cent) provided information regarding employees, though the level of detail differs. Some banks had only a single sentence while other banks (such as Animal Resources Bank in Sudan) provided a relatively large number of sentences regarding employees.

The item in our benchmark disclosed by most banks was the report of the Sharia Supervisory Board, where twenty-one banks (72 per cent) provided such a report. Banks in Iran and Pakistan, where the economic system is fully Islamized but AAOIFI standards are not required, do not provide a Sharia Supervisory Board report. This can be compared to Sudan (also a fully-Islamized economy), where banks provide such a report according to AAOIFI requirements. However, not all the banks in Sudan follow the form of report suggested by AAOIFI: Banks audited by the government general auditor, such as Khartoum Bank and Animal Resources Bank, provide a summarized Sharia audit report. These banks are less likely to follow the detail of AAOIFI standards. Overall, banks disclosing a substantial amount of social information (measured by number of sentences) tend to achieve this by providing extensive disclosure in a small number of categories rather than less detailed disclosure across a wider range of categories.

CONCLUSIONS AND IMPLICATIONS

This study applied an Islamic perspective to develop a benchmark for social reporting by Islamic banks. Contrary to our expectations, the empirical findings suggest that social issues are not of major concern for most Islamic banks. This may in part reflect the fact that most Islamic banks operate in less developed economies where social concerns, especially as regards issues such as the environment, may be given less importance (Belal, 2000). However, Muslims in the countries where Islamic banks operate are likely to have a high expectation of the banks’ social role. This has been recognized by the management of some Islamic banks, such as Jordan Islamic Bank,11 and this bank provides a broader range of social disclosures compared to most other Islamic banks in our sample.

We found that banks required to pay Zakah provide more social disclosures than banks not required to do pay Zakah. However, much of the incremental social information for those banks is about Zakah itself: As Zakah is one of the five pillars of Islam, banks that pay Zakah are, not surprisingly, more likely to want to show how they comply with this basic Islamic principle. Although the Islamic banks operating in non-fully-Islamized economies make more social disclosures than others, the difference in volume of disclosure was not statistically significant. Similarly, banks following AAOIFI standards tend to provide more social disclosures than non-compliant banks, though the difference in volume of

11 This observation is based on interviews carried out by the first author in Jordan Islamic Bank in 2002.
disclosure was not found to be statistically significant. Both these results may reflect the relatively small sample size (as only one-third of full-flagged Islamic banks could be investigated), and further research with a larger sample may be worthwhile.

Most of the Islamic banks publish the report of the Sharia Supervisory Board, reflecting the importance of the report for Islamic banks as providing the necessary assurance for the users of financial statements that the bank adheres to Islamic principles. Banks may consider that provision of the report is sufficient for users, avoiding the need for detailed disclosure in the annual reports. Interestingly, banks in Iran, where a full Islamized economy is in operation, do not provide such a report because the banks are required by law to follow Islamic principles.

Islamic banks, in general, do not disclose information about activities that may attract criticism, such as unlawful (haram) transactions and their policy for dealing with insolvent clients. Some Islamic banks charge clients who are late in repaying their loans penalties that may take the form of interest, which is strictly prohibited by Islam. None of the banks in our sample disclosed how they deal with insolvent clients. This suggests that Islamic banks may be avoiding issues affecting their Islamic image, while 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, because a ‘negative corporate image can have a serious economic implication for organizations’ (Buhr and Freedman, 2001, p. 294). This represents a conundrum as the principles of full disclosure and accountability of individuals and organizations to 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.

As a religion and a culture, Islam presents an absolute ethical code, Sharia, which imposes strong social obligations on Muslim individuals and organizations. Islamic organizations, such as Islamic banks, are accountable to God and to the communities in which they operate and have a duty of truthful disclosure. Based on these principles, we have developed a benchmark for social disclosure by Islamic banks and investigated the extent to which Islamic banks are providing social disclosures at present. The evidence suggests that, with a few exceptions, Islamic banks have some way to go in meeting the expectations of the Islamic community.

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