

**Secular Effect of Social Responsibility
In Islamic Banking**

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Abstract

The purpose of the paper is to give an overview of the social responsibility of Islamic banking, by focusing on the Islamic view and the effectiveness on business and socio-economic life in a way that is different from the conventional understanding of CSR. This paper aims to explore the concept of corporate social responsibility in Islam with different perspective on framework and systems theories. This is on the Islamic perspective of accountability, social justice, and ownership, for social disclosures, which is expects Islamic banks to provide services that take into account the special social role of these banks. In this regard, the objective of social responsibility disclosure in Islamic banking is highlighted and thereupon, contributes a benchmark for social disclosure by Islamic banks, which is pragmatic and takes in to account the different secular effects facing Islamic banks.

1- Introduction

The teachings of Islam dictate that social responsibility integrated with business models or corporate social responsibility (CSR) is an integral component of life whereby giving back to the community is of utmost importance. While the world faced with a backdrop of global challenges including multicultural diversity, business needs to incorporate religion for best CSR practice

In recently times, western capitalism has begun a transition toward a model, which recognizes the business case for socially responsible behavior. This transition has been widely documented and researched and is well known amongst both academics and practitioners¹. Therefore, where as the western business model has begun to change by becoming more ethical, more stakeholder-oriented, and more socially responsible, there still appears to be a divide between what this new CSR based model has to offer and what Muslim stakeholders appear to care about.

This paper seeks to explore this area by focusing on the Islamic view and the effectiveness on business and socio-economic life in a way that is different from the conventional understanding of CSR. The concept of corporate social responsibility will be suggested to be consistent with an Islamic view of society in this paper.

Islamic economic ideology and values require successfully imple mented economic and social justice and fair distribution of income and wealth throughout the Islamic society. In this approach, the banking system is a place to accumulate the wealth of the rich and to use it to improve the society's well being in the context of Islamic regulations and financial systems. The objective of the Islamic banking system is to make a positive contribution toward the fulfillment of socio-economic objectives of the society in all spheres.

Usmani asserts that the philosophy behind Islamic banking was "aimed at establishing distributive justice free from all sorts of

¹ Stiglitz, Joseph (2002) "Globalization and its discontents", New York: Norton & Suliman, M. (2000) "Corporate Reporting from an Islamic Perspective". Accountant National. October, pp. 18-22. & Wolf, Martin (2004) "Why Globalization Works", Yale University Press

exploitation”¹ According to Islamic principles, business transactions can never be separated from the moral objectives of society². The social function of Islamic banks represents a major part in their activities: in fact, “social activities are emphasized in Islamic banks’ articles of association with their objectives and functions”³. Merged with this function is the social role of Islamic Banks that entails social justice and accountability, requiring the banks to disclose corporate social responsibility (CSR) information. Islamic banks have been described as having “a social face”⁴. The existence of such religious banks, which abide by Islamic principles and operate in Islamic societies, provides us with an opportunity to explore the social reporting of such banks.

The social function of Islamic banks represents a major part in their activities: in fact, “social activities are emphasized in Islamic banks’ articles of association with their objectives and functions”⁵. Merged with this function is the social role of Islamic Banks that entails social justice and accountability, requiring the banks to disclose corporate social responsibility (CSR) information. Islamic banks have been described as having “a social face”⁶. The existence of such religious banks, which abide by Islamic principles and operate in Islamic societies, provides us with an opportunity to explore the social reporting of such banks

This paper aims to explore the concept of corporate social responsibility in Islam with different perspective on framework and systems theories. In this respect the benchmark of social report is developed. This is on the Islamic perspective of accountability, social

¹ Akacem, M and Gilliam, L. (2002), “Principles of Islamic banking: Debt versus equity financing”, Middle East Policy, Washington, Vol. 9, No. 1, p113

² Arab and Islamic Law Series, Kluwer Law International, Amsterdam

³ El-Ashker, A. (1987), The Islamic Business Enterprises, Kent: Croom Helm. P 45

⁴ Mashhour, N., (1996), Social and Solidarity Activity in Islamic Banks, Cairo: The International Institute of Islamic Thoughts [in Arabic].p 33

⁵ El-Ashker, A. (1987), The Islamic Business Enterprises, Kent: Croom Helm. P 45

⁶ Mashhour, N., (1996), Social and Solidarity Activity in Islamic Banks, Cairo: The International Institute of Islamic Thoughts [in Arabic].p 33

justice, and ownership, for social disclosures, which is expects Islamic banks to provide services that take into account the special social role of these banks. Such expectations will take into consideration the special nature of the banking industry (which requires certain types of social disclosures but not others). The objective of social responsibility disclosure is highlighted in the next section together with enlightenment of the theoretical framework and system theories on social responsibility disclosure in Islam. The remaining part of this chapter contributes a benchmark for social disclosure by Islamic banks, which is pragmatic and takes in to account the different secular effects facing Islamic banks.

2- Corporate Social Responsibility Definition

The concept of social responsibility or known as corporate social responsibility (CSR) is an elusive abstract and may a mean of number different things. Over the 50 years' business, ethics and management theorists have developed much effort to thinking through the business-society relationship¹. These ethicists developed models that could be modified or compromised to suit evolving social interest.

The ethical models such as Eternal Law, Distributive Justice, Rights and Relativism, provide a background of corporate social responsibility. As Waheed, A. elaborates the Corporate Social Responsibility is achieving commercial success in ways that honor ethical values and respect people, communities, and the natural environment. The CSR means addressing the legal, ethical, commercial, and other expectations society has for

¹ For example, see Beachamp. T.L. and Bowie, N.E. (Eds.) (1997), *Ethical Theory and Business*, Upper Saddle River, NJ: Prentice Hall & Bowen, H.R. (1953), *Social Responsibility*, New York: Harper, Row & Carroll, A. B. and Buchholtz, A. K. (2000), *Business and Society: Ethics and Stakeholder Management*, 4th edition, Cincinnati, Ohio: South-Western College Publishing, Carroll, A.B. (1977), *Managing Corporate Responsibility*, Little, Boston and Toronto; Brown and Co, Carroll, A.B. (1991) "The Pyramid of Corporate Social Responsibility: Toward the Moral Management of Organisation Stakeholders" *Business Horizons*, 34, Donaldson, T. and Preston, L.E. (1995) *The Stakeholder Theory of the Corporation Concept: Concept, Evidence and Implication*, *Academy of Management Review*, 20, Ducker, Peter, F. (1984), "The New Meaning of Corporate Social Responsibility", *California Management Review* 26, Waddock S and Smith, N. (2000)

business, and making decisions that fairly balance the claims of all key stakeholders¹. There have been efforts to conceptualise ethical behavior in terms of the business practice of corporations in society.

With regard to all the above, a concord in thinking about corporate social responsibility has not been provided, in fact a range of explanations and justification exists among business scholars with regard to whom corporations have a responsibility to and what these responsibilities are. Some have argued that a corporation has no responsibility beyond legally making a profit for the shareholder or owner². Yet others have argued that a corporation has numerous responsibilities that can be derived from ethical principles and moral values³.

What is common throughout most of these definitions is the idea that a corporation must be mindful to its role within society and effects of its business practice. These definitions recognize that an action by one party does have an impact on the other party. A corporation is not detached from society. Instead, a mechanism that is able to provide for societal wants and needs⁴.

The World Bank defines corporate social responsibility comprehensively. According to this definition, Corporate social responsibility is to be the commitment of owners of commercial activities to contribute to sustainable development through working with their employees and their families, local community and the society as a whole to upgrade the people's living standards in a certain way that serves commerce and development in the same time. As per the international chamber of

¹ Waheed, A. (2005), "Evaluation of the State of Corporation Social Responsibility Pakistan and Strategy for Implementation for Securities and Exchange Commission of Pakistan and United Nation Development Program" PAK/98/011 PARADIGM-UNDP, September. p 13

² Friedman, M. (1970). "The Social Responsibility of Business is to increase its Profits." New York Sunday Times Magazine, 13 September, 32-4

³ Freeman, R. E. (1984), *Strategic Management: A Stakeholder Approach*. Pitman London. & Carroll, A.B. (1993), "Business & Society: Ethics and Stakeholder Management (2nd ed), Cincinnati, OH: South-Western Publishing Co., Carroll, A.B. (1999). "Corporate Social Responsibility: Evolution of a Definitional Construct", *Business & Society*, 38 (3), & Donaldson, T. and Preston, L.E. (1995) "The Stakeholder Theory of the Corporation Concept: Concept, Evidence and Implication." *Academy of Management Review*, 20

⁴ United Nations Industrial Development Organization (2002), *Corporate Social Responsibility: Implications for Small and Medium Enterprises in Developing Countries*, Vienna

commerce definition, social responsibility is to be all the attempts that contribute to the volunteering of co-operations to achieve development for ethical and social reasons. Hence, social responsibility depends on good initiatives of businessmen without any legal obligations. Therefore, social responsibility is achieved through convincing and educating.

Consequently, the concept of corporate social responsibility abstracts the expectations that society has of business not to harm, but to contribute positively to well the being of others

3- Corporate Social Responsibility in Islam

The concept of social responsibility in Islam is the contribution of the idea of social responsibility and justice. This perspective on social responsibility lays the foundation for the study of Islamic understandings and practice of corporate social responsibility. From this viewpoint, within Islam, as it is practiced amongst Muslims, the relationship between commercial activity and civil society is taken as part of everyday life and the rules of practice are embedded in the Islamic precepts

3-1 Framework of Corporate Social Responsibility in Islam

The fundamental codes of moral behavior are e.g. truthfulness, trust worthiness, generosity and leniency, adherence to business commitments and contracts, fair treatment of workers. It is also required to avoidance of evil practices such as, interest (riba), fraud, cheating, deceit, hoarding of foodstuff, exploitations, giving short measures, etc. in accordance to the Islamic jurisprudence (fiqh) concerning the lawful (halal) and unlawful (haram) are essential elements of social responsibility and justice in Islam and are part of the overall Islamic faith¹.

Much of the Islamic ethical behavior is concerned with elements of social responsibility and justice. In order to determine the efficacy of these elements and systematize them in a coherent framework, it is important to establish the foundational elements. This foundation will form the basis of the conceptual framework of CSR in Islam that will

¹ Mohammed, J.A. (2007), "Corporate Social Responsibility in Islam" Thesis submitted to Auckland University of Technology. Faculty of Business, New Zealand

address not only the nature of the elements of social responsibility and justice but also the rationale behind them¹. Syed Nawab Haider Naqvi tendered a theory of Islamic economics in which he addresses the need for an Islamic economic system and how it can be generated from the ethical statements in the Qur'an and Hadith. He presents the four ethical axioms - Unity, Equilibrium, Free Will, and Responsibility that together form such a logical system and argues that from these four axioms, all statements regarding Islamic society and economics can be generated. These axiomatic principles will be used along with some other scholars' work to elaborate the conceptual framework of CSR in Islam².

The foundational axioms operationalised the aspirations of Islamic beliefs in aiming for the creation of human-centric economics. In other words, Naqvi, Ghazali, and Ariff developed an axiomatic approach to justify the Islamic economic strategy by treating Islamic ethos as an ideal through which social and economic policies dealing with poverty reduction are assessed³. These axioms are:

Tawhid (unity) is related to the political, economic, social, and religious aspects of men's life. This is the vertical dimension of Islam.

Al-'adl wa'l-ihsan (equilibrium): The axiom of equilibrium (al'adl) corresponds to the axiomatic concept of unity. In addition, (al'adl) in a deeper sense denotes a balance of forces, constitutes the horizontal dimension of Islam.

¹ Ibid

² Naqvi, S. N. H., (1994), *Islam, Economics, and Society*, London: Kegan Paul International.

³ Al-Ghazali, A.H.M. (1990), *Ihya Oulum Aluddin*, HB, 765pp, Pakistan, Darul-Ishaat, Vol.2 &3, and Naqvi, S. N. H., (1994) "Islam, Economics, and Society". London: Kegan Paul International, and Arrif M. (ed), (1982), *Monetary Policy in an Interest free Islamic Economy: Nature and Scope* Jeddah: International Centre for Research in Islamic Economics in Asutay, M. (2007). "Conceptualisation of the Second Best Solution in Overcoming the Social Failure of Islamic Finance: Examining the Overpowering of Homoislamicus by Homoeconomicus." Discussion paper, IIUM Journal of Economics and Management 15, no. 2 by The International Islamic University Malaysia pp 167-195

Ikhtiyar (free will), which implies as a human, is free to decide how to exercise and contribute to the society. However, this freedom is qualified by the rules of the Shari'ah Free Will (Ikhtiyar) is an element that each individual has, and it provides humankind with the ability to make choices in situations where there may be opposing issues involved.

Fard (responsibility), it is the responsibility of every individual to care for the needy in society. This axiom implies that individuals and society need to be accountable for their actions and conserve the public good.

Tazkiyah, which implies growth with purification should endogenise the good of others and has to be conducted with ethical and moral considerations.

Khilafah, indicates an individual's role as God's vicegerent on earth. Islam teaches that a person has been endowed with a free will to make his/her own choices, thereby making his/her own way of achieving success in this life and salvation in the hereafter. Naqvi further explains that one's ability to make the right choice is man's role as the Allah's - The Most Exalted (TME), vicegerent (Khalifah) on earth. This vicegerency is more virtuality than an actuality. However, it is an individual's goal to act in a manner such that such a situation acquired.

Maqasid-al Shari'ah, which is the last axiom, aims to interpret the text and in restoring the principles of Islamic economics in relation to the objectives of the Shari'ah. This is further interpreted in a way that Islamic economic principles must lead to 'human well-being'.

These axioms define the economic framework for economic activity to take place within intra-and intergenerational social justice, which reveal themselves in the methodological framework of the social responsibility and justice in Islam and thereby Islamic economic system¹.

¹ Asutay, M. (2007), "Conceptualisation of the Second Best Solution in Overcoming the Social Failure of Islamic Finance: Examining the Overpowering of Homoislamicus by Homoeconomicus." Discussion paper, IIUM Journal of Economics and Management 15, no. 2 by The International Islamic University Malaysia p 170

In addition to this, these axioms are implemented quite extensively in Islamic banks and are the core values and foundation of any Islamic business and society behavior guide. All of these characteristics of a unique precept in business conduct prescribed by Islam form the foundation of an Islamic business and society. Thus, an axiom system that reflects the Islamic view of ethics needs to be constructed as an essential first step in determining the rules of social and economic behavior in an Islamic society.

3-2- Content of Social Responsibility in Islam

In the past, the more secular approach of western capitalism with its focus on materialism, competition, profit maximization, and shareholder primacy has appeared at odds with the Islamic approach and has raised challenges for companies wanting to do business with Muslim stakeholders¹.

Recently, western capitalism has begun a transition towards a model, which recognises the business case for socially responsible behavior. This transition has been widely documented and researched and it is well known amongst both academics and practitioners. It opens up the prospect that differences in management styles may become less acute and less of a barrier to successful international business ventures. In turn, this might lead to positive returns as the opportunities of closer integration deliver wider benefits all rounds².

Although the western business model has begun to change into a more ethical, more stakeholder-oriented, and more socially responsible model, there still appears to be a divide between what this new CSR based model has to offer and what Muslim stakeholders appear to care

¹ Al-Qaradawi, Y. (1985), *Al-Halal wal Haram fil Islam* (The lawful and the prohibited in Islam), Kuala Lumpur: Islamic Book Trust

² Stanley, T.M., (1990), "Ethical Perspectives on the Foreign Direct Investment Decision", *Journal of Business Ethics* 9 (1), pp1-10, Stiglitz, Joseph (2002), *Globalization and its discontents*, New York: Norton, Bhatia, Lord Amir (2004) "CSR: An Islamic Perspective" at a conference on "Singapore/UK Developing Corporate Social Responsibility" at the Shangri La hotel in Singapore on February 23rd and Wolf, Martin (2004) "Why Globalization Works", Yale University Press

about. The aims of the Islamic system of business are therefore not primarily materialistic but are based on the concepts of human well being and achieving a good life overall. It stresses community values, socio-economic justice, and a balance between the material and spiritual needs of its followers¹.

Islamic economics in its modern sense came into existence in the early 1970s mainly as a critique of the capitalist economy in relation to economic development. Therefore, in the opinion of the founding fathers, the failure of economic development was attributed to capitalist economic development strategies, which ignored the importance of human being and his/her well-being. Their objective was therefore to develop an economic system understanding, which could develop a human-centric development strategy².

The Islamic economics aimed at a world order, where the ontological and epistemological sources namely the Qur'an and hadith determine the framework of the economic value system, the operational dimension of the economy and the behavioral norms of the individual Muslims. Islamic economics, thus, is an "approach to, and process of, interpreting and solving the economic problems of human beings based on the values, norms, laws and institutions found in, and derived from the sources of Islam".

This, however, implies a systemic understanding and a political dimension. Recalling modern Islamic economics emerged as part of the Islamic movement in the 1970s with political visions and aspirations and individual politics. Thus, it is not very surprising that Islamic economics were perceived as a complementary part of this political project. However, Islam does not subscribe to the foucaltian philosophy, in which power is central to the definition of social and political

¹ Ahmad, K., (1971) *Islam: Basic Principles and Characteristics*, University of Karachi: Karachi and Chapra, M. U., (1992), "Islam and the Economic Challenge" Virginia: International Institute of Islamic Thought

² Asutay, M. (2007), "Conceptualisation of the Second Best Solution in Overcoming the Social Failure of Islamic Finance: Examining the Overpowering of Homoislamicus by Homoeconomicus." Discussion paper, IIUM Journal of Economics and Management 15, no. 2 by The International Islamic University Malaysia p 170

meanings, actualisation, and knowledge. Nevertheless, since Muslims do not have such global power, they were deprived of establishing their political and economic order.

This has consequences for Islamic finance, which is the operational tool of Islamic economics. Since Islamic finance is the institutional aspect of Islamic economics, because it finances the economic activity in an Islamic framework, thus there is a need to have institutions using instruments, which operate according to the rules, and regulations, which are all bound by the Shari'ah. Islamic finance, hence, refers to the institutions, which in the inspirational sense aim to operationalise and fulfill the economic systems of Islam. Since the systemic understanding of Islamic economics could not be achieved, Islamic finance has developed its own working framework in a very pragmatist manner; it has ended up being located within the neo-classical paradigm¹

4- Social Responsibility and Islamic Banking

Islamic banking system is a part of the overall Islamic value system and is not merely about refraining from interest-based transactions. The objective of the Islamic banking system is to make a positive contribution to the fulfillment of socio-economic objectives of the society in all spheres. Many Islamic banking scholars, including Ahmad², Mirakhor³, Warde⁴, Lewis and Algoud⁵ and Iqbal and Molyneux⁶, assert that although Islamic banks perform mostly the same functions as conventional banks, they do this in distinctly different ways. In their views, these are the salient features of Islamic banking

¹ Ibid p174

² Ahmad, A. (2000). Economic Development in Islamic Perspective Revisited. *Review of Islamic Economics*, 9, 83-102.

³ Mirakhor, A. (2000), General Characteristics of an Islamic Economic System, in A. Siddiqi, *Anthology of Islamic Banking*, Institute of Islamic Banking and Insurance, London. 11-31.

⁴ Warde, I. (2000), *Islamic Finance in the Global Economy*. Edinburgh University Press, Edinburgh

⁵ Lewis, M. K. and Algoud, L. M. (2001). *Islamic Banking*, Edward Elgar. Cheltenham, UK.

⁶ Iqbal, M. and Molyneux, P. (2005), *Thirty Years of Islamic Banking: History, Performance, and Prospects*, Palgrave Macmillan. New York.

and finance, which make it distinct and unique from its conventional counterparts.

Islamic banks are those banks that follow Islamic Shari'ah in their business transactions and strive for a just, fair, and balanced society as envisioned by the Islamic economics. The precepts of shari'ah in the financial field are to establish social security, property rights, and the rights of progeny. In the extensive domain of shari'ah, these goals are combined with the directive of preservation of the Islamic State.

Within the mix of the above-mentioned shari'ah precepts, the social, economic, and political goals are taken up together with the financial ones. These together comprise the totality of the social, economic, and political development issues of an Islamic society. Hence, when Islamic banks are linked with such a comprehensive network of goals in the light of shari'ah, the totality of the socioeconomic and sociopolitical goals along with the financial ones would predominate in the objective criterion of an Islamic bank.

For example, in an attempt to secure the funds of its clientele, the shari'ah recommends ways, which embrace the tenet of securing property rights; the Islamic bank must embrace the other shari'ah tenets as well. Thereby, socioeconomic development goals become important in the shari'ah determined social wellbeing function. The social wellbeing function as the objective criterion of the Islamic bank serving the tenets of maintaining social security, protection of progeny and preservation of the Islamic State, become a description of ways and means of financing resource mobilization that establish sustainability and the high ideals of Islamic faith.

Among other things, Shari'ah prohibits dealing in interest and undertaking transactions with unknown fate, while at the same requiring transactions to be lawful (halal), and requires Muslims to pay the religious tax Zakah. Abolishing interest from their dealings is the fundamental principle on which Islamic banks are based¹.

¹ Maali, B., Casson, P. and Napier, C. (2003) "Social Reporting by Islamic Banks, Discussion Papers in Accounting and Finance", University of Southampton

Islam's strict ban on dealing with interest seems to have social roots. Mirza and Baydoun¹ argue that the use of Riba (usury) violates the principle of social justice, which is very important in Islam, because it leads to gratifying people without them making an effort. Those who lend money on interest do not make an effort, nor do they participate in the risks of the projects financed, and such behavior is rejected by the teachings of Islam. Interest-based transactions allow lenders to receive the advantages associated with lending their money, while avoiding the risks and losses attached to ownership. This is what Gambling and Karim² refer to as "unfair trading". Talip and Phay³ suggest that the most apparent reason for the ban of Riba is to impose the spirit of goodwill between Muslims.

Some of the salient features, which have been mentioned earlier, make Islamic banking distinct and unique from its conventional counterparts. Islamic banking strives for a just, fair, and balanced society as envisioned by the Islamic economics. Hence, the many prohibitions (e.g. interest, gambling, excessive risks, etc.) are to provide a level playing field to protect the interests and benefits of all parties involved in market transactions and to promote social harmony. For example, the prevailing practice of interest in the conventional banking system involves injustice to the borrowers since the interest on their loans has to be paid irrespective of the outcomes of their business. Similarly, interest contracts can be unjust to the lenders especially when their returns on deposits, which have been channeled by the banks to the

¹ Mirza, M. and Baydoun N. (2000), "Accounting Policy Choice in Riba-Free Environment" *Accounting, Commerce & Finance: the Islamic Perspective Journal*, Vol. 4, No.1, p. 36.

² Gambling T., and R. and Karim, R. (1993) "Creditable Organizations: Self Regulation v. External Standard Setting in Islamic Banks and British Charities", *Financial Accountability & Management* 9 (3) August, p. 34

³ Talip, A. and Phay T. (1998), "The Islamic Economics System and Riba: The Foundation of Islamic Banking, Accounting, Commerce & Finance", *The Islamic Perspective Journal*, Vol. 2, No.3, p. 65.

entrepreneurs, do not commensurate with the actual performance of the investment¹.

On the other hand, Islamic banking is constructed upon the principle of brotherhood and cooperation, which stands for a system of equity sharing, risk sharing, and stake taking. It promotes such sharing and cooperation between the provider of funds (investor) and the user of funds (entrepreneur). Moreover, Islamic banking as a system grounded on ethical, and a moral framework of the Shari'ah, Islamic banking is also characterized by ethical norms and social commitments². There is a moral filter based on the definition of halal (permissible) and haram (prohibited and undesirable) operating at different levels, carving the conscience of entrepreneur and firm, promoting a positive social climate for society, and providing an expedient legal framework.³.

The question that may raise here is why Islamic banks are expected to have such an important social function, even maybe more than other business enterprises. The Islamic banks have appeared after a long period of decline in financial activities based on Islamic principles. During the period when Islamic economic activities were not available, the Islamic charitable organisations were very active and strong. This has led people to perceive any Islamic organisation as a charity. The implication of such an image for Islamic banks is that people have a very high expectation on the social side from Islamic banks. In addition, Al-Mograbli 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

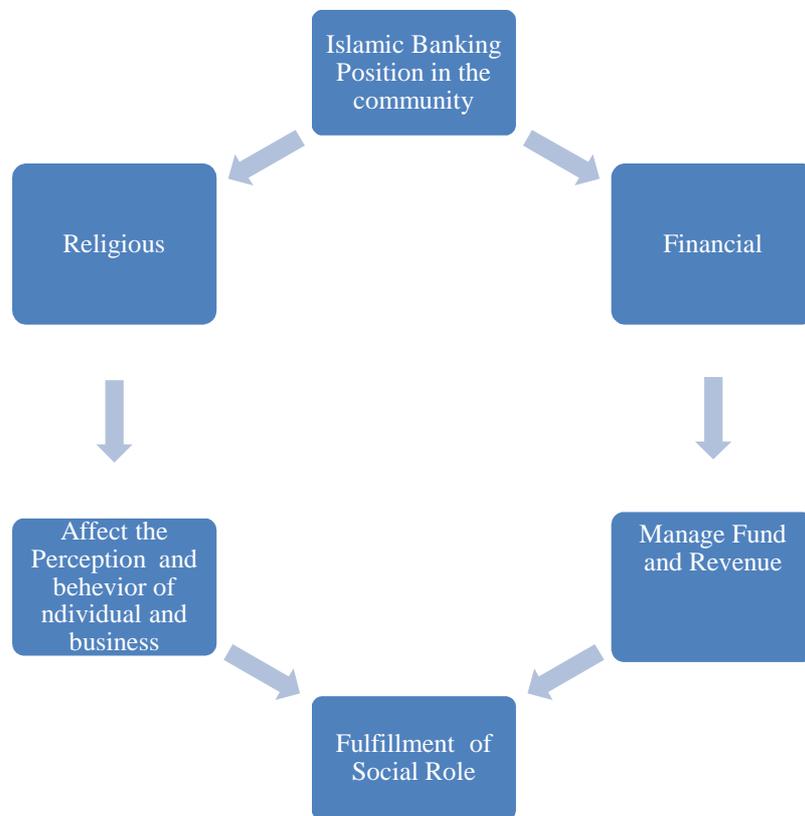
¹ Lewis, M. K. and Algaud, L. M. (2001), *Islamic Banking*, Edward Elgar Cheltenham, UK & Iqbal, M. and Molyneux, P. (2005), *Thirty Years of Islamic Banking: History, Performance, and Prospects*, Palgrave Macmillan. New York.

² Ahmad, A. (2000), *Economic Development in Islamic Perspective Revisited*. Review of *Islamic Economics*, 9, 83-102. & Mirakhor, A. (2000), *General Characteristics of an Islamic Economic System*, in A. Siddiqi, *Anthology of Islamic Banking*, Institute of Islamic Banking and Insurance, London. 11-31. Warde, I. (2000), "Islamic Finance in the Global Economy", Edinburgh University Press, Edinburgh

³ Wajdi Dusuki; A & Dar; H. (2007), "Does Corporate Social Responsibility pay off? An Empirical Examination of Stakeholder Perspective", Loughborough University Loughborough U.K

example for people in the community, who watch their activities. The banks, in their operations and activities, affect the perceptions and behavior of individuals and businesses within the community. On the financial side, the banks' control of large funds and revenues helps them to undertake a social role¹.

Figure1: Diagrammatic Presentation of Islamic Banking Position in the Community and its Social Role



¹Al-Mograbi, A.(1996), The Social Responsibility of Islamic Banks, Cairo”, The International Institute of Islamic Thoughts [in Arabic]

The Islamic Finance characteristics somehow imply the relevance and significance of social responsibility as a globally accepted practice for Islamic banks. The Islamic banking system has an in-built dimension that promotes social responsibility, as it resides within a financial trajectory underpinned by the forces of Shari'ah injunctions. These Shari'ah injunctions interweave Islamic financial transactions with genuine concern for ethically and socially responsible activities at the same time prohibiting involvement in illegal activities or those, which are detrimental to social and environmental well-being¹.

5- Benchmark for Social Disclosures by Islamic Banks

The social disclosure by Islamic banks is meant to examine how well the banks are disclosing the information that might be useful to the stakeholders. This information is developed to help the stakeholders i.e. depositors, shareholders, religious bodies, government etc to evaluate the performance of the Islamic Banks as well as the social responsibility. Since the most accessible source of information is the annual report, it tries to assist the users of these annual reports so that from the limited information available in them, they can derive some conclusions on how the Islamic banks have performed in the previous year, and how they are going to perform in the near future. Nevertheless, since the indices are developed merely based on what has been made available in the annual report, perhaps it might give an inaccurate picture of the actual performance. However, this approach might induce the organisation to disclose more information, not based only on the regulatory requirements but based on what they should disclose.

So based on the principles and objectives set out above, and the nature of Islamic banking operations; in addition to financial reports, a number of items should be disclosed in Islamic banks' annual reports. All the items chosen are supported by literature from various authors and sources. It considers that such items should be disclosed by Islamic

¹ Wajdi Dusuki; A & Dar; H. (2007), "Does Corporate Social Responsibility pay off? An Empirical Examination of Stakeholder Perspective", Loughborough University Loughborough U.K

banks wherever they operate, regardless of the local regulations, the broader social and political environments, and size of Muslim population. This approach might induce the organisation to disclose more information, not only based only on the regulatory requirements but also based on what they should disclose. This is because the need to report such items is based on the moral responsibility implicitly accepted by such religious banks. This benchmark is based on the broader concept of accountability that Islamic banks accept ethical issues. It is pragmatic and takes into account the different secular effects facing Islamic banks.

Yaya and Hameed claim that as one of the Islamic business institutions, the Islamic banks are not only obliged to report the information regarding the economic performance of the Islamic banks but also the information about the banks' achievements in fulfilling their proper and adequate financial reporting on Shari'ah compliance and social and environmental concerns as a whole of their stakeholders¹. It is supported by SFA (Statement of Financial Accounting) No.1 on Objectives of Financial Accounting for Islamic Banks and Financial Institutions (AAOIFI). According to this particular statement, the objectives of financial reports on the Islamic banks should provide the following types of information:

- I. Information about the Islamic banks' compliance with the Shari'ah principles
- II. Information which indicates the prohibited earnings and describes the expenditures in which they occurred and the manner in which they were disposed
- III. Information about the Islamic banks economic resources and related obligations to satisfy the right of the owners or the right of others
- IV. Information to assist the concerned party in determination of Zakat on the Islamic bank's funds and the purposes for which it will be disbursed

¹ Yaya, R and Hameed, S.M.I. (2003). "The Future of Islamic Corporate Reporting: Lessons from Alternative Western Accounting Report" Paper presented in the International Conference on Quality Financial Reporting and Corporate Governance, Kuala Lumpur

- V. Information to assist in estimating cash flow that might be realized from dealing with the Islamic banks, the timings of those flows and the risk associated with their realization
- VI. Information to assist in evaluating Islamic bank's discharge of its fiduciary responsibility to safeguard funds and to invest them at reasonable rate of return, and information about rates of returns on the bank's investment and the rate of return accruing to equity and investment account holders
- VII. information about the Islamic bank's discharge of its social responsibility

In addition to the above, the AAOIFI standard (2002) has defined the basic elements of financial statements. It consists of statement of financial position, income statements, and statement of changes in owners' equity or statements of retained earnings, statement of cash flows, statement of changes in restricted investments and their equivalent, statement of sources and users of funds in Zakat and charity fund, and lastly, statement of sources of fund in qard fund¹.

With regard to the elements of financial reporting, the Islamic banks financial reporting should consist of several principle elements to attain the ultimate objectives of Islamic financial institutions. Basically, it has proposed several elements should be reported by Islamic banks such as information that identifies clearly the Islamic investment and the non-Islamic investment. The information that identifies the halal (lawful) and haram (unlawful) revenues. This provides the statement of changes in restricted investments, information which provides the statement of sources and uses of funds in Zakat and Qard Hassan (loan and fund), information which provide the statement of sources and use of funds in the qard funds, information which clearly identifies the sources of revenue.

¹ AAOIFI (2003) Accounting, Auditing & Governance Standards for Islamic Financial Institutions, 4th Edition, AAOIFI, Bahrain.

Hence, based on the above statements and standards, essentially the Islamic benchmark for the preparation of the financial report is the use of fair/market value principle. This particular valuation can only be used if there is a strong basis for valuation (i.e. honest professional surveyor) and not just merely based on individual discretion to establish the relevance and reliability of financial report.

In addition to financial reporting, there is a need to practically to look at the environmental reporting and social reporting. It refers to the disclosure of financial and non-financial, quantitative and qualitative information about the activities of an enterprise. Social responsibility accounting in essence, concentrates on the social issues that might include the employee reports, human resource accounting, and industrial democracy issues¹. The Table 1 shows the items to be disclosed by Islamic banks.

¹ Mathews, M.R. (1994), "Twenty-Five Years Of Social And Environmental Accounting Research: Is There A Silver Jubilee To Celebrate?" *Accounting, Auditing & Accountability Journal*, Vol. 10, No. 4, pp481-531

Table 1 : The Social Disclosure by Islamic Banks

Area	Items to be disclosed	AAOIFI	Comments
Shari'ah opinion	Report of Shari'ah Supervisory Board	Required	
Unlawful (haram) transactions	Nature of unlawful transactions Reasons for undertaking such transactions The Shari'ah Board view about the necessity of these transactions The amount of revenue or expenses from these transactions How the bank disposed, or intends to dispose, of such revenues	Required Not req. Not req. Required Required	The statement required by AAOIFI includes Zakah and charity together
Zakah (for banks required to pay it)	Statement of sources and uses of Zakah The balance of the Zakah fund, and reasons for non-distribution Shari'ah Board attestation regarding the computation and distribution of the funds	Required Required Not req.	The statement required by AAOIFI Includes Zakah and charity together
Zakah (for banks not required to pay it)	The amount due in respect of shares and deposits The Shari'ah Board' s opinion regarding validity of computation	Required Required	Required by AAOIFI standards as a statement
Charitable and social activities	The nature of charitable and social activities financed The amount spent on these activities The sources of funds used to finance these activities	Required Required Required	Required by AAOIFI as part of Zakah statement
Employees	The policy on wages and other remuneration The policy on education and training of employees The policy of equal opportunities The policy on the working environment	Not req. Not req. Not req. Not req.	
Environment	The amount and nature of any donations or activities undertaken to protect the Environment The projects financed by the bank that may lead to harming the environment	Not req. Not req.	
Other aspects of community involvement	The bank' s role in economic development The bank' s role in addressing social problems	Not req. Not req.	

Source: Maali, B. &Casson, P. &Napir, C.¹

¹ Ibid

6- Conclusion

The extensive research from an Islamic perspective deduced from the Hadith exemplifying the holy Prophet Mohammed's (PBUH) preaching and practice of social responsibility and justice and the Qur'anic commandments provide enough evidence that a concept similar to that of the prevailing notion of CSR has been an integral part of Islamic society. The guidelines in the Shari'ah specifically address issues concerning the general well being of both businesses and society. Moreover, the axioms that are the core values and foundation of any Islamic business and society guide day-to-day behavior, they are more descriptive of the ethical philosophy of Islam.

The fundamental basis of the conceptual framework of CSR, which shows congruency between the idea of social responsibility and justice in Islam, could be depicted as diagrammatically as figure2:

Figure2: Diagram of the Conceptual Framework of Corporate Social Responsibility in Islam



The concern for CSR is also relevant to Islamic banks as a highly prominent sector in the Islamic social economy organisation. Islamic banking is obliged to certain social objectives intended for the benefit of society. This is because Islam is an ethical system, which guides mankind in all his activities including commerce and trade. Usmani asserts that the philosophy behind Islamic banking was ‘aimed at establishing distributive justice free from all sorts of exploitation’¹. According to Islamic principles, business transactions can never be separated from the moral objectives of the society. Thus, characteristics

¹ Maali, B., Casson, P. and Napier, C. (2003) “Social Reporting by Islamic Banks”, Discussion Papers in Accounting and Finance, University of Southampton P 113

of the framework of CSR in Islam are present under current practices found in Islamic banks but are not followed perfectly.

In this study, an Islamic perspective to develop a benchmark for social reporting by Islamic banks is examined. The performance of Islamic banks nowadays is under critical public scrutiny. The banks have to ensure that not only are their products and services effective in meeting the needs of various stakeholders, but more importantly they have to make sure that their activities are in line with the Shari'ah requirements. The importance of the social report by Islamic banks would be that it would lead interested parties to evaluate the performance of the banks inspecting the annual reports. Thus, social disclosures are used by the banks to construct a positive Islamic image, because a "negative corporate image can have serious economic implications for organisations"¹. However, the principles of full disclosure and accountability of individuals and organisations 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.

¹ Buhr, N. and Freedman, M. (2001), "Culture, Institutional Factors and Differences in Environmental Disclosure Between Canada and the United States". *Critical Perspectives on Accounting*, Vol. 12, p. 294.

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