

# THE ISLAMIC VALUES LINKING WITH THE SOCIAL RESPONSIBILITY DISCLOSURE BY SUDANESE ISLAMIC BANKS

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## Abstract

*This conceptual paper has critically reviewed the literature seeking to establish a relationship between corporate social responsibility (CSR) from Islamic perspective and the Islamic values, represented in this study by Shariah Supervisory Board (SSB) of the Islamic bank. The paper aims at providing evidence on the significance of the characteristics of Shariah Supervisory Board that can possibly assist in explaining variations in the quantity and quality of social responsibility disclosure in the annual reports of Sudanese Islamic banks. The paper provides an analysis of findings of previous studies with particular reference to system-oriented theories such as political economy theory and legitimacy theory. Several methods have been used to collect and analyse the literature. In the first place, research has been conducted using the Google search engine. In the second place, researches on five databases pertaining to social sciences have been examined using the various search engines (i.e. Emerald, EBSCOHost, Spring-Link, Springer link, and JSTOR). The findings of this study indicate that the characteristics of Shariah Supervisory Board; particularly, the board size, educational qualification of the members, cross-membership, and reputation of the board members will enhance the level of monitoring and compliance with Islamic Shariah and subsequently, lead to a high level of social responsibility disclosure in the annual reports of Islamic banks.*

**Keywords:** Accounting; Islamic Banks; Corporate Social Responsibility Disclosure; Shariah Supervisory Board

2016 GBSE Journal

## Introduction

Islamic banks are required to operate in conformity with the rules and principles of Islamic Shariah. The prohibition of Riba (usury) is one of the most contributing principles that necessitates the need for Islamic banks and at same time trying to maintain its social role. Based

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on the social role, Islamic banks provide social information to show their responsibility and accountability beyond the society, to Allah (Muwazir et al. 2006, cited in Abdul Rahman & Bukair, 2013), and giving relevant information in conformance with religious needs of Muslim decision makers. In order to encourage sustainable economic growth based on the Islamic social accountability, Islamic banks continue to implement new financing strategies, and look for further means of investment that may promote the development and creation of the small-scale traders (Abdul Rahman & Bukair, 2013; Bhatti & Bhatti, 2010)

Little attention has been given to the issue of corporate social responsibility (CSR) from Islamic perspective (see for instance, Abdullah et al., 2013; Abdul Rahman & Bukair, 2013; Farook et al., 2011; Hassan & Latiff, 2009). Broadly speaking, Islamic banks are categorised as highly visible institutions in the society as financial intermediaries which attract and allocate funds (Maali et al., 2006). Notably, Islamic banks have an additional role in the society, as they can potentially help individuals and communities to apply justice in all facets of their life based on the Islamic banking system (Farook et al., 2011). According to the Governance Standard for Islamic Financial Institutions No. 7 (AAOIFI, 2010), Islamic banks are required to involve in social activities as one of their religious, economic, legal, ethical and discretionary responsibilities, and they ought to disseminate these activities to the Islamic “*Ummah*” as the financial intermediary for Islamic community. This paper contributes to the literature in the area of CSR disclosure from an Islamic perspective. The paper is motivated by the absence of the examination of the effects of Shariah Supervisory Board’s attributes on levels of social disclosure in Sudan.

This paper is organised into eighth sections. The next section introduces the historical background of Islamic banking in Sudan, the third section briefly reviews the relevant literature concerning the history of CSR disclosure by Islamic banks, using the historical knowledge of CSR disclosure and key factors that influence the level of CSR disclosure in Islamic banks. The fourth section presents a theoretical foundation for CSR disclosure from the Islamic perspective. The fifth section displays the proposed theoretical framework. The sixth section develops propositions for further investigations. The seventh section covers the research method employed to obtain and analyse the previous literature and methods to be used to empirically test the research. An finally, the eighth section provides a conclusion of the paper

## **Background of Islamic Banking in Sudan**

The Sudanese banking system is distinctly featured as the first Islamic based banking system in the world, which is, in fact, the Islamic bases known as Shariah and it adopts a banking system that does not deal with the interest rates. The first initiative to provide Islamic banking services is dated back to 1977 by establishing Faisal Islamic Bank (Sudan) in Khartoum. It has been, of course, since 1983 adopting an Islamic banking system in all over Sudan. However, in 2005, when the Comprehensive Peace Agreement (CPA) between Sudanese government and Sudan People’s Liberation Movement/Army (SPLM/A) was signed, Southern Sudan was exempted from the Islamic banking system and remained working with the conventional system. At that time, the central bank of Sudan was worked with two systems: Islamic one in Northern Sudan

and another conventional in Southern Sudan. However, the Sudanese banking system was also worked with one monetary policy which is governed by two different banking systems.

After the secession of Southern Sudan from the Republic of the Sudan on July 9, 2011, not only the dual system has, in effect, been suspended but also the whole policies connected with the traditional system of Southern Sudan. Thus, the bank of Southern Sudan has become itself a central bank for the Republic of South Sudan and all former branches of Sudan Central Bank in all Southern states follow it. In addition to this, article (14) of (CPA) that relates to wealth division protocol, and monetary, banking, currency and loans policy was suspended too.

## Literature Review

### Corporate Social Responsibility Disclosures from the Islamic Perspective

Each business enterprise claims that it follows Islamic principles have to fully incorporate Islamic values into their business objectives and practices. This incorporation is expected to lead to corporate behaviours that are different from that in the Western market economy where profits maximisation - including profits from interest on loans - is the ultimate aim of business. In the context of Islamic business world, businesses have to demonstrate their accountability to Allah and fulfilment of social objectives (Aribi & Gao, 2010).

Based on the Shariah principles, a few researchers have developed disclosure index as benchmark to explore the level of CSR disclosure in the annual reports (see for instance; Abdullah et al. 2013; Maali et al., 2006). As mentioned above, a little attention has been given to the issue of CSR disclosure from Islamic point of view, Consequently, the research in the area of CSR appears to suggest that, to the best of my knowledge, there is only few studies (see for example, Ibrahim et al., 2015) have investigated the issue of CSR disclosure in Islamic banks sector in Sudan. This study is therefore intends to fill this gap in the literature.

### The Shariah Supervisory Board (SSB)

The Central Bank of Sudan (CBS) requires Islamic banks to have their own Shariah Supervisory Board according to Governance Standard for Islamic Financial Institutions No.1 (AAOIFI, 2010). The main function of SSB in Islamic banks is to directing, reviewing and supervising the activities of Islamic Financial Institution (IFI) in order to ensure that they are in compliance with Islamic Shariah Rules and principles (AAOIFI, 2010). Accordingly, the existence of a SSB and its characteristics will lead to greater monitoring and, in turn, greater disclosure of CSR information. The degree to which the SSB would influence CSR disclosure may also depend on the characteristics of the corporate governance mechanism (Farook et al., 2011). Previous studies highlighted four factors as the main characteristics of SSB that can influence the level of CSR disclosure. These factors include: *Number of Board Members (size of the Board)*, *Cross-Membership*, *Secular Education Qualifications*, and *Reputable SSB Members*.

### Size of Board

Shariah supervision may be performed by an individual supervisor/advisor, or by a board of supervisors/advisors, commonly known as a Shariah Supervisory Board (DeLorenzo, 2010). Dhouibi & Mamoghli (2013) argued that an increase in the number of SSB board members implies a greater level of compliance with Islamic laws and principles and leads to higher levels of CSR disclosure. Governance Standard for Islamic Financial Institutions No.1 states that SSB should consist of at least three members (AAOIFI, 2010). In Sudan, for instance, there are no restrictions on the number of SSB members, with the desired number comprising between three to seven members (Ibrahim et al. 2015).

### **Cross-Membership**

Cross-directorship yields more transparent information through implementing decisions made on one board as input for the decisions on another board. Farook et al. (2011) stressed that a positive relationship exists between cross-membership and the level of social information disclosed by an Islamic bank.

### **Educational Qualifications of the Members**

A Shariah supervisor will be someone with strong knowledge base in the classical Shariah science, as well as, understanding of modern finance, markets, and economics. The educational knowledge of SSB members has been proposed to influence the level of disclosure (Hambrick & Mason, 1984). The members who are not highly educated may be undermined in their abilities to fully apply theoretical Islamic laws and principles. Hence, scholars with a doctoral degree in business and economics are arguably better informed of the current situation.

### **Reputable SSB Members**

The SSB may be composed of Shariah Scholars with tacit knowledge about the application of Islamic law. It is commonly accepted that reputation is regarded as a proxy for industry knowledge and hence, reputable scholars with relevant degrees in Shariah and business are more likely to understand the current implications of Islamic banking, especially with regards to the issue of CSR disclosure (Farook et al., 2011).

As far as the CSR disclosure and the characteristics of SSB are concerned, the measurements of SSB characteristics are summarised in Table 1 below, whereas CSR disclosure is measured by constructing a disclosure index contains all the activities expected to be carried out by IFI to fulfil their social responsibility, as stated by Governance Standard NO.7 (AAOIFI, 2010).

**Table 1: Summary of the measurements of SSB characteristics**

<b>Variable</b>	<b>Measurement</b>
<i>Number of Board Members</i>	Dichotomous; 1 for banks with 5 or more members and 0 for less than 5
<i>Cross-Membership</i>	Dichotomous; SSB member with crossmembership:1, otherwise: 0
<i>Educational</i>	Dichotomous: SSB member with doctorate qualification: 1,

<i>Qualifications</i>	otherwise: 0
<i>Reputable SSB Members</i>	Dichotomous: reputable SSB member: 1, otherwise: 0

**Source:** Abdul Rahman & Bukair (2013)

### Theoretical Insights

In the western world, researchers developed many theories to answer the question of why firms involve voluntarily in social activities and then disclose social information to the public (Gray et al., 1995). These theories determined the user group of such social information, where there are various potential users with varying degrees of importance for the firm. Each theory has its own explanations and justifications for social disclosure. While the questions of why the firms disclose these information and what is the appropriate form and content of social information disclosure remain debatable questions. These imply that CSR is a phenomenon for which it is difficult to find explanations (Campbell, 2000). From Islamic perspectives, corporations are seeking to fulfil the needs of Islamic community by emphasising the principle of full disclosure through annual reports. The term full disclosure means that Islamic banks should provide all necessary information to the “Ummah” about their transactions (Maali et al., 2006).

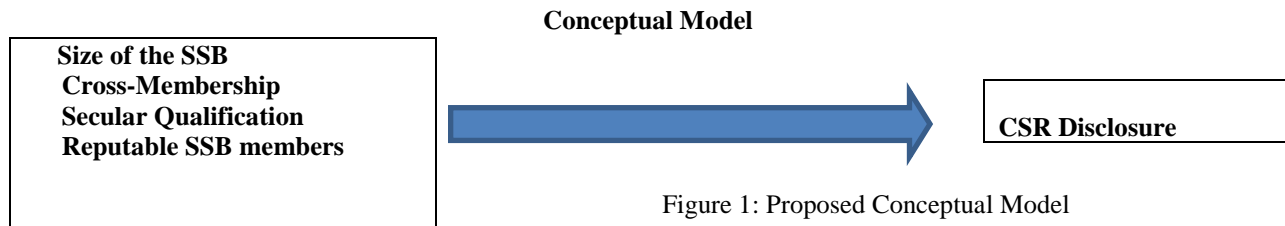
Researchers used various theories to explain why firms disclose social information, such as legitimacy theory and political economy theory. Suchman, (1995,p. 574) defines the legitimacy theory as “A generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs and definitions”. While Zald, (1970, p. 233) defines the political economy theory as “... the study of the interplay of power, the goals of power wielders and the productive exchange system”. The relationship between individuals, organisations and society is consequently viewed as a “social contract” (Deegan, 2002; Williams, 1999). Organisations constantly kept seeking to ensure that they operate within the bounds and norms of their respective societies (Deegan, 2002).

CSR from Islamic perspective early emphasised the idea of this ‘social contract’ that necessarily has to do with the congruency of the value system of the organisation to the larger value system of an Islamic community. Lewis, (2001, P. 113) states that the implications for business enterprises is that “both management and providers of capital, are accountable for their actions both inside and outside their firms; accountability in this context means accountability to the community”. In Islam, likewise, organisations are accountable to society as are the individuals.

### Conceptual Framework

Gray et al. (1995) argued that the proponents of system-oriented theories claim that corporations provide CSR information as part of the dialogue between the corporation and greater society (The social contract). The organisations legitimacy will be threaten if the organisations failed to conform to the society’s expectations (Deegan, 2002). That is, the management of organisation is required to disclose social information to the public in order to prove that they comply with the social contract.

A number of factors that relate to the SSB's characteristics (i.e. number of board members, cross-membership, secular education and reputable scholars) may determine how effectively the SSB undertakes its role and conducts its functions and subsequently influences the level of CSR disclosure made by Islamic banks. The system-oriented theories are, thus, considered the suitable theoretical foundation to explain the behaviour of Sudanese Islamic banks to participate in social activities, and subsequently CSR activities. The relationship between the characteristics of SSB and the level of CSR disclosure is illustrated as follows:



## Propositions

The propositions of this study are based on prior studies in this area of research. Each of the propositions is stated in the alternative hypothesis form. It states the nature of the effect of one explanatory variable on the dependent variable. In addition, the hypothesised relationship, positive or negative is given in accordance with the measurement of the variables stated.

### Size of Shariah Supervisory Board

Regarding the size of SSB, this study suggests the following proposition:

- *There is a positive relationship between the size of SSB and the level of social responsibility disclosure from the Islamic perspective in the annual reports of Sudanese Islamic banks.*

### Cross-Membership

Having reviewed the studies related to the Cross-membership and CSR disclosure, this study formulates a proposition as follows:

- *The presence of SSB members with cross-directorship results in disclosing more Islamic social information in the annual reports of Sudanese Islamic Banks.*

### Secular Education Qualifications

Concerning the secular education of SSB members, the following proposition can be stated:

- *There is a positive association between the secular education of SSB members and the level of CSR disclosure in annual reports of Sudanese Islamic Banks.*

### Reputable Scholars

The relationship between the reputation of SSB members and the level of CSR disclosure can be postulated in the following proposition:

- *The highly reputable the SSB members are, the higher the level of CSR disclosure in the annual reports of Sudanese Islamic Banks.*

## Research Methodology

This conceptual paper is based solely on a review and analysis of research and data from the literature. Several methods have been used to collect and analyse the literature. Firstly, research was conducted using the Google search engine. Terms such as CSR disclosure in Islamic banks and Islamic Financial Institutions, and Shariah Supervisory Board are utilised. Secondly, researches on five databases pertaining to social sciences were examined using the various search engines (i.e. Emerald, EBSCOHost, Spring-Link, JSTOR, and Springer LINK).

Based on the literature reviewed in this paper, a quantitative study could be conducted to obtain data on CSR disclosure practices and measure the research variables. A quantitative method could be applied because the research questions would be a causal one. The unit of analysis will be the annual reports of Sudanese Islamic banks with the sample population to be studied comprising all of the Sudanese Islamic banks that have their own SSBs. Accordingly, the sample size will comprise 30 Sudanese Islamic banks which almost represent the whole population, as there are just 32 Islamic banks operating in Sudan.

## Conclusion

The last few decades witnessed a huge expansion in the area of Islamic finance. Specifically, Islamic Banking can be seen as new ideas and applications to bring Islamic values and social justice into the financial and economic fields. Consistent with Islamic principles, Islamic banks have a duty to fulfil an ethical role inherent in their character as collective religious obligation. The objective of this paper is to review the previous literature that deal with the issue of social information disclosure in the annual reports of Islamic banks.

Hence, this paper investigates the link between the characteristics of the Shariah Supervisory Board and the level of CSR disclosure in the annual reports of Sudanese Islamic Banks. The reviewed studies have shown that Islamic banks which have SSB consists of more than three members, the cross-directorship of SSB members, Ph.D qualifications and reputation; will result in a greater level of monitoring, and more compliance with Islamic Shariah and principles, and subsequently, this will lead to the high level of social responsibility disclosure in the annual reports of Islamic banks.

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