

Shariah Disclosure in Islamic Banking Institutions: The Customers' Perspectives

Muhammad Ismail

Ph.D. Scholar in Islamic Business & Finance at Center for Excellence in Islamic Finance, Institute of Management Sciences, Peshawar

Zohra Jabeen

Assistant Professor at Institute of Management Sciences, Peshawar



Scan for Online Version

Abstract

Despite other fundamental differences, Shariah governance (SG) is one of the crucial organizational arrangements within the Islamic bank's corporate governance (CG) architecture that make Islamic bank different from their conventional counterpart. Due to SG, the management ensures whether or not their bank's products, services, and operations are in-line with the defined rules of Shariah. This Shariah ensurity is crucial because the concern investment and deposit making stakeholders chooses Islamic banking institutions (IBIs) in order to protect their religious commitments and belief. Therefore, stakeholders are very interested in the Islamicity disclosure and extent of compliance with SG's attributes of the Islamic banks. The main purpose of this study is to explore the main SG related attributes wherein both the concern investment and deposit making stakeholders are interested. To achieve this purpose, Phenomenological research design, of the qualitative research approach, adopted. Phenomenology is one of the widely used qualitative research strategy wherein the knowledge is make on the basis of individuals' lived experiences. The present study explored 22 attributes, classified in 5 dimensions, in which the Islamic banks' customers are interested and that need to be communicated through bank's annual report and website.

Keywords: *Disclosure, Islamic Banking, Reporting, Shariah Governance, Shariah Compliance.*

1. Introduction:

Islamic banking is a faith based banking system, inspired from the Islamic law of business¹. Therefore, a large number of customers choose IBIs because of the Islamicity of its products, services, operation, and all other kind of financial activities². Pakistan is among those countries across the globe that established on the ideology of Islam. The creation of a separate country for the Muslims of the sub-continent was to provide a space to the Muslims where they can protect their religious commitments and ideological stance.

Therefore, Pakistan was created on this faith centered ideology, which means that here the Muslims citizens will be provided an environment in which they ensure their financial, social, economic, inter-personal, and religious activities according to the tenets of Shariah. In Pakistan, Islamic banking was also introduced on this approach as well³. Therefore, both the existing and potential Islamic banks' customers are keen interested in knowing the Shariah information disclosure of the IBIs, because to protect their religious commitments. That's why, to stay connect the existing customers and attract the potential customers, IBIs need to ensure full Shariah information disclosure and transparency.

In the established Islamic finance literature, a lot of work has been done concerning the disclosure framework and mechanism of the IBI. However, little concentration has been given to the Shariah information disclosure that proposed by the IBI's existing and potential customers. Therefore, the fundamental objective of the present study is to explore the attributes and information, especially related to Shariah, that need to be disclose in the IBI's annual reports and websites. Phenomenological based research was conducted in order to achieve the purpose of this study. Phenomenology is a unique kind of qualitative research strategy, wherein a researcher explores the phenomena based on the individuals' lived experiences concerning that particular phenomenon. Structurally, the paper is divided into six main sections. The second explored the existing phenomena and concepts from the relevant established literature, third section framed all the existing concepts and identified space for the missing concepts, methodological approach of the study explained in section four, the primary findings are explained in section five, while the last section concluded this research.

2. Literature Review:

There is not a standardized definition of SG and different scholars and researchers made different definition based on their personal approach, however, Zulkifli Hasan, a prominent SG expert, viewed about SG that it is the set of rules, regulation, and organization arrangement on the basis of which IBIs ensure the Islamicity of its operations, products, and services. It is relatively an adequate definition of SG that covered almost each aspect of the governance. In the definition, organization arrangement refers to different the different SG's department, such as, Shariah supervisory board (SSB), Shariah compliance department, Shariah audit department, Shariah review department, Islamic product and services development department, etc. While the second part of the definition, that is, rules and regulations refer to the concern departments' standard operating procedures (SOPs). SG is not a separate governance structure that supplements CG within IBIs but it is an additional mandatory arrangement within the Islamic bank's CG architecture⁴. This views is also supported by Qattan (2003) who argued that SG is a unique building block in the CG architecture of IBIs⁵. This means that

SG is the only corporate governance arrangement that differentiate Islamic from its conventional counterpart. Furthermore, SG is mandatory for IBIs and conventional banking institutions (CBIs) are free from such regulation.

The involvement of Shariah experts in the CG's activities of an Islamic bank gives rise to some unique issues, such as, independency, confidentiality, competency, consistency, and disclosure⁶. While, Hamid, Ubud, Djumahir, & Siti (2016) added transparency and reputation, respectively, in the list of issues that arise due to the engagement of Shariah advisors in the Islamic bank's corporate governance system⁷. Independency refers to the separation to dominance of SSB from board of directors (BOD) and management, confidentiality means ensuring secrecy of the bank's personal documents related to product and service, competency is about hiring competent members for SSB, consistency means that the Shariah pronouncements made by the SSB should be consistent all time, disclosure is about communicating all the concern SG and compliance related information that are important to the concern stakeholders, transparency means true information should be disclosed, and reputation means the status of Islamic bank's SSB in the eyes of concern and potential stakeholders⁸. There is a detailed literature established on each of these issues, however, the focus of the present study primarily on the disclosure issue.

Many researchers contributed to the disclosure discussion and framework within the IBIs. The nature of those studies varies from geography to geography, researcher to researcher, context to context, and most importantly regimes to regimes. Ramli, Majid, Muhamed, & Yaakub (2014) worked on the Shariah governance and compliance disclosure in IBIs. They make a comprehensive SG disclosure index on the basis Bank Negara Malaysia's (BNM) Shariah compliance disclosure requirements for IBIs. The geographical context of their study was Malaysia⁹. They make comprehensive list of information which they grouped in eight different categories. Azid & Alnodel (2019) constructed a checklist of twenty Shariah disclosure items which were extracted from Accounting and Auditing Organization for Islamic Financial Institutions' (AAOIFI) governance standards. They conducted their study in Saudi Arabia, as Saudi Arabia and other Gulf countries followed AAOIFI's governance standards¹⁰. Abdullah, Percy, & Stewart (2013) constructed two different information checklists, related to SSB and Zakat¹¹. Concerning SSB they make a checklist of nine attributes while a checklist of 10 attributes was made for Zakat. Both of their checklists were inspired from AAOIFI governance standards, Islamic Financial Service Board's (IFSB) guidelines, BNM's guidelines, and Bank Indonesia's (BI) disclosure

requirements. The geographical context wherein they conducted their research was Malaysia and Indonesia. The entire attributes which they selected for their study was appropriately fit in the Malaysian and Indonesian regulatory regimes.

Majid, Sulaiman, & Ariffin (2010) conducted their research in Malaysia and constructed corporate governance disclosure index by exploring 123 disclosures attributes which then they classified into fourteen different groups¹². The information which they gathered in their disclosure checklist was extracted from the AAOIFI governance standards-I, Islamic Financial Service Board's (IFSB) guidelines, and BNM's disclosure requirements. They checked their index on the annual reports of Malaysian Islamic banks for a certain period of time. Masruki, Kumar, & Hanefah (2018) also conducted their disclosure study in Malaysia and constructed Shariah disclosure index¹³. They make a comprehensive checklist of thirty seven SSB's related attributes, categorized in five different categories. The information extracted from BNM's Shariah governance framework-2010 and Malaysian Islamic Financial Service Act-2013.

3. Conceptual Framework:

Based on the above discussion we developed the following conceptual framework, shown in Figure 3.1. The conceptual framework shows that disclosure in IBIs is a four folded phenomena in which every concern has their own requirements for information disclosure. An adequate Shariah disclosure information framework may developed by the bringing the inputs of all these four concern stakeholders. Regulators, central bank or security and exchange commission, has their own information disclosure requirements which they issued through governance framework or issued guidelines. Academicians and the foundational scholars in Islamic finance have their own requirements toward Shariah information disclosure. Different standards sitting agencies has their own standards wherein they ensure full disclosure. While, the concern and potential investment and deposits making customers have their own requirements in which they are interested. Therefore, an acceptable and ideal Shariah information disclosure framework will be one which developed by incorporating the disclosure requirements of all these four stakeholders. Furthermore, all the stakeholders' disclosure requirements are available in the established therefore they are given in gray three boxes, in the following conceptual framework. However, the Shariah disclosure requirements of the Islamic banks' existing and potential customers are given in, a different, comparatively light gray color dashes box. The reason is that, the present

study will explore the Shariah information disclosure requirements by arranging experiential interviews of the IB's customers.

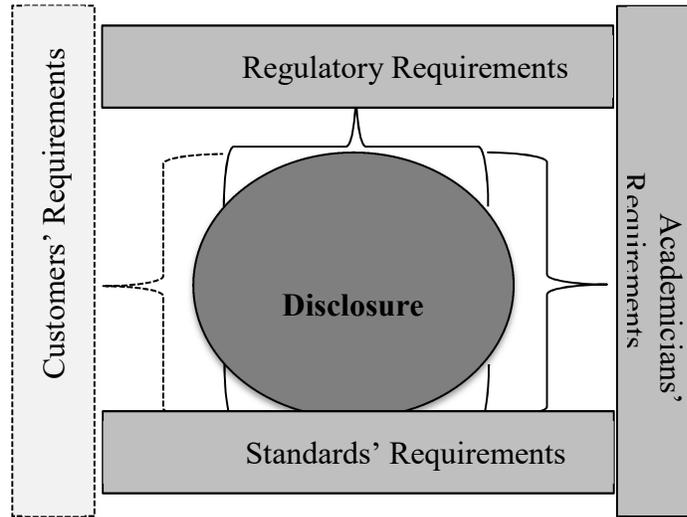


Figure 3.1: *Four folded Shariah information disclosure framework for IBIs*

4. Methodology:

The methodological route adopted for the present study is qualitative while Phenomenology opted as a research strategy. Phenomenology is considered an ideal choice when the phenomena, under inquiry, studied through the lens of individuals' lived experiences¹⁴. Also, phenomenology is one of the frequently used research strategy in exploratory research¹⁵. To justify phenomenology for the present study we've make the following arguments:

- a) The present study is exploratory in nature, as we've to explore those Shariah information that need to be disclosed to both the concern and potential IB's customers.
- b) The phenomena under study, Shariah information disclosure, will be observed only the concern IB's customers which are lived.
- c) Only that content will be included in Shariah information disclosure checklist, which is important to the IB's customers based on their personal experiences.

The graphical representation of the methodological process flow followed in present study is shown in Figure 4.1. Concerning sample size, the customary sample size, used in phenomenological studies that conducted in the same region, technique is adopted. Noreen & Rehan (2016) conducted their study in Islamic corporate governance and they selected six

sitting in a particular bank's SSB.

5.2 Investment:

We have also explored eight different attributes that we merged in four different attributes while the foundational roots of all these four attributes were related to banks' investment. The IBI's customers are keen interested in knowing about the Islamic banks' business details, their proof of Islamicity, the details of avenues where the current account deposits are invested, and the detail of warehouses where IBIs keep their selling products.

5.3 Accounts:

There are six other attributes, created from eleven items, which we explored from the interviews. These sort of information were actually related to Islamic banks' financials, therefore we named this dimension accounts. Some customers said that IBIs need to disclose their loses, detail about how and why the IBIs paying only profit on regular basis without making negative profit, the detail of profit paid at least in the last five years, detail of IB's techniques toward profit and loss calculation, debt to equity ratios, and the amount of Zakat paid.

5.4 Products:

Concerning products we identified only two attributes but these are the most important. During the interviews, every customer said that we are very interested to know that how the IBI's products are free from interest and how it is different in conventional banks. Also customers highlighted that I am interested in see in the Islamic banks' websites about special products, services, and facilities offered to the aged citizen of our society.

5.5 Miscellaneous:

We also identified certain other information that was five in number. We grouped in miscellaneous dimension. The reason was that their nature was totally different from each other. Here the some customers outlined that we are interested to know about a particular Islamic bank's ranking based on their multi-dimensional performance, some were interested the age of a particular IBI, other were interested in knowing IBI's external Shariah audit report, while a customer expressed that he is interested to know about a particular IBI's employees knowledge toward Islamic banking and finance and its concern products.

Dimensions	Information Disclosure
1. SSB	1.1 Status and authority of SSB's members 1.2 Piety of SSB's members 1.3 Intersect diversity of SSB 1.4 Experiences and qualifications of SSB's members 1.5 Number of female Shariah scholars in SSB 1.6 How long the Shariah scholars attached with the bank
2. Investment	2.1 Details of the bank's businesses 2.2 Halal certification of the business 2.3 Where the bank's current account deposits invested 2.4 Details about bank's warehouses
3. Accounts	3.1 Bank loss statements 3.2 Disclosure of Bank's Zakat 3.3 Details of the profit stabilization funds 3.4 Details of the profit rate of the previous five years 3.5 Profit and loss sharing technique 3.6 Debt and equity composition
4. Products	4.1 How the products are interest free 4.2 Products, services, and facility for aged and senior citizens
5. Miscellaneous	5.1 Bank ranking with other peers Islamic banks 5.2 Age of the bank 5.3 Bank staff awareness regarding Shariah and Islamic finance 5.4 External Shariah audit report

Table 5.1: *List expected information disclosure information in IBIs*

6. Conclusion:

The paper concluded that disclosure, especially Shariah disclosure, in Islamic banking institutions is a four folded phenomena. In an ideal Shariah disclosure framework, the information's inputs comes from four different sides, such as, mandatory disclosure requirements of the regulators, voluntary disclosure requirements from the Islamic finance academicians and scholars, standardized disclosure requirements from international standard sitting agencies, and recommended disclosure requirements from the existing and potential customers. Therefore, the present study focused on the Shariah information disclosure recommended by the IBIs existing and potential customers. The study explored 22 different information disclosures, in which

the IBI's customers are keen interested, which then categorized into five different dimensions. These dimensions include details about SSB, banks' investments, accounts, products, and other miscellaneous information. These are the information which customers believed to be communicated through banks' annual reports and websites. The present study presenting a guideline that how can IBIs protect the confidence of their existing and potential customers through an ideal and four folded Shariah information disclosure framework. Furthermore, the research contributed to the existing literature of Shariah disclosure in IBIs. The findings of this research broaden the understanding and approach toward the classical disclosure frameworks suggested in prior studies.



This work is licensed under a [Creative Commons Attribution 4.0 International License](https://creativecommons.org/licenses/by/4.0/).

References

- ¹ Ahmed, Habib. 2011. "Maqasid Al Shariah and Islamic Financial Products: A Framework for Assessment." *ISRA International Journal of Islamic Finance* 3 (1): 149-60.
- ² Al-Mehmadi, Faisal Bin Sulaim Bin Sulaiman. 2004. "The External Reporting Needs Of Investors in Islamic Banks in Saudi Arabia: An Exploratory Study of Full Disclosure (PhD Dissertation)." University of Dundee.
- ³ Ullah, Karim. 2014. "Adaptable Service-System Design: An Analysis of Shariah Finance in Pakistan." Brunel University, London.
- ⁴ Grais, Wafik, and Matteo Pellegrini. 2016 "Corporate Governance in Institutions Offering Islamic Financial Services Issues and Options." 4052, November 2006. World Bank Policy Research Working Paper.
- ⁵ Qattan, Muhammad A. 2003. "Shari'ah Supervision: The Unique Building Block of Islamic Financial Architecture." In *International Conference on Islamic Banking: Risk*
- ⁶ Grassa, Rihab. 2013. "Shari'ah Governance System in Islamic Financial Institutions: New Issues and Challenges." *Arab Law Quarterly* 27 (2): 171-87. <https://doi.org/10.1163/15730255-12341254>.
- ⁷ Hamid, Wahyuniati, Salim Ubud, Djumahir, and Aisjah Siti. 2016. "Trade Principles and Sharia-Adherence Banking Performance Analysis by Employing Maqasid Islamic Shariah Index Approach: Study on Indobesian Sharia Bank." *Journal of Agricultural and Socio-Economic Sciences (RJOAS)* 11 (59): 66-74. <https://doi.org/10.18551/rjoas.2016-11.04>.
- ⁸ Zainuddin, Zaemah, and Norhafiza Nordin. 2016. "Addressing Governance Issue in Islamic Real Investment (I-REITs): A Case Study for OIC Country - Malaysia." *International Journal of Islamic Business* 1 (1): 60-75.
- ⁹ Ramli, Nathasa Mazna, Amilia Syuhada Abdul Majid, Nurul Aini Muhamed, and Nor Asiah Yaakub. 2014. "Shariah Governance Disclosure Index and Institutional Ownership of Islamic Financial Institutions in Malaysia." In *Proceedings of 5th Asia-Pacific Business Research Conference*, 1-14. Kuala Lumpur,

- Malaysia.
- ¹⁰ Azid, Toseef, and Ali A. Alnode. 2018. "Determinants of Shari'ah Governance Disclosure in Financial Institutions: Evidence from Saudi Arabia." *International Journal of Ethics and Systems* 35 (2): 207-26. <https://doi.org/10.1108/ijoes-07-2018-0111>.
 - ¹¹ Abdullah, Wan Amalina Wan, Majella Percy, and Jenny Stewart. 2013. "Shari'ah Disclosures in Malaysian and Indonesian Islamic Banks: The Shari'ah Governance System." *Journal of Islamic Accounting and Business Research* 4 (2): 100-131. <https://doi.org/10.1108/JIABR-10-2012-0063>.
 - ¹² Majid, Norakma Abd, Maliah Sulaiman, and Noraini Mohd Ariffin. 2010. "Developing a Corporate Governance Disclosure Index for Islamic Financial Institutions." In *8th International Conference on Islamic Economics and Finance*, 1-25. Doha, Qatar: Center for Islamic Economics and Finance, Qatar Faculty of Islamic Studies. <http://www.iefpedia.com/english/wp-content/uploads/2011/12/Norakma-Abd-Majid.pdf>.
 - ¹³ Masruki, Rosnia, Bablu Dhar Kumar, and Mustafa Mohd Hanefah. 2018. "Shariah Governance Practices of Malaysian Islamic Banks in the Light of Shariah Compliance." In *2nd International Halal Management Conference (IHMC), At The Maldives National University*.
 - ¹⁴ Creswell, John W. 2014. *Research Design: Qualitative, Quantitative, and Mixed Methods Approach*. Los Angeles: Sage Publications, Inc.
 - ¹⁵ Abdullah, Binti Hanimoon. 2014. "An Exploratory Examination into the Relationship between Corporate Governance and Risk Management in Islamic Banks: Disclosure and Survey Analysis." Durham University UK.
 - ¹⁶ Noreen, Shama, and Fawad Rehan. 2016. "Corporate Governance In Pakistan Islamic Financial Institution Maintaining Moral & Challenges." *International Journal of Management Sciences and Business Research* 5 (12): 40-49.