THE EXTENT OF INFORMATION DISCLOSED IN THE PRACTICE OF ISLAMIC BANKING ANNUAL REPORTS

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THE EXTENT OF INFORMATION DISCLOSED IN THE PRACTICE OF ISLAMIC BANKING ANNUAL REPORTS

By

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ABSTRACT

This research investigates the extent of disclosure in Islamic banking annual reports. The period of study is from year 1997 to 2006, a period after the regulations for financial reporting rapidly developed. This study reviews the issues on disclosure extent and the Shari’ah perspectives related to contracts, governance and disclosure. Information disclosure can be divided into two categories - voluntary and regulated. The traditional view on disclosure highlighted that the added value of information can be used to reduce conflicts. Meanwhile, from the perspective of the Shari’ah, the contracting parties need to observe the Shari’ah principles in identifying the information that need to be disclosed. This study examined the disclosure practice of 95 annual reports of full-fledged Islamic banks (IB) and windows (Islamic banking scheme or IBS). Comparative analysis on the practices of IB and IBS indicated that information disclosed in the IB’s and IBS’s annual reports are slightly different especially for voluntary disclosure and in the period before and immediately after the enforcement of disclosure regulations (2000-2003). Furthermore, this study found that: i) bank size, board independence and the number of Shari’ah committee members significantly determine the extent of voluntary disclosure; ii) bank size, liquidity, board committee, board independence and audit committee independence significantly determine the extent of regulated disclosure; iii) size and board independence significantly determine the extent of all type of disclosure; and iv) there is an evident of co-integrated relationship among a few sets of variables in the long run. Overall, the minimum best practices are not satisfactorily met judging from both voluntary disclosure and the level of conformity to regulations. Regulators may find these findings to be useful for Shari’ah governance and monitoring purposes as well as in promoting transparency, ‘market discipline’ and the social functions of this industry to the Muslims.

Keywords: Disclosure, Islamic Banking, Financial Reporting, Index Construction
ABSTRAK


Katakunci: Pendedahan, Perbankan Islam, Pelaporan Kewangan, Pembangunan Indeks
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LISTS OF ABBREVIATIONS

AAOIFI  Accounting and Auditing Organisations of Islamic Financial Inst.
AIMR  Association for Investments Management and Research
BIMB  Bank Islam Malaysia Berhad
BNM  Bank Negara Malaysia
BNM/GP  Bank Negara Malaysia Guiding Principle
BMI  Bank Muamalat Indonesia
BMMB  Bank Muamalat Malaysia Berhad
CEO  Chief executive officer
DI  Disclosure Index
FRSi-1  Financial Reporting Standards for Islamic Financial Institutions
GLS  Generalised least squares
GP  Guidelines on the Specimen Financial Statements
GP8-i  Guidelines on the Specimen Financial Statements for Licensed Islamic Banks
IASB  International Accounting Standard Board
IB  Islamic Banks
IBS  Islamic Banking Scheme
MASB  Malaysian Accounting Standards Boards
MD  Maximum Disclosure
OLS  Ordinary least squares
PMGE  Pooled Mean Group Estimator
RD  Regulated Disclosure Items
SC  Shari'ah Committee
SPTF  Skim Perbankan Tanpa Faedah
TD  Overall Disclosure Items
TRI-1  Accounting for Zakat on Business
TRI-3  Presentation of Financial Statements of Islamic Financial Institutions
TRI-4  Ijarah
TRI-4  Shari'ah Compliant Sale Contract
VD  Voluntary Disclosure Items
WTO  World Trade Organisation
DI_IB  Index of Islamic bank full-fledge
DI_IBS  Index of Islamic banking scheme
Glossary of Islamic Terms

This section explains some of the Islamic words and terms occurring in this study to avoid misconceptions.

Allah: Although the word Allah is often translated as “God”, there are some significant differences between the two words. According to Islamic belief, Allah is the Creator, and sovereign ruler of the universe.

Bai Bithamin
Ajil: Deferred payment sale.
Fikh: Understanding of Shariah. In Islamic jurisprudence, it is the science of interpretation of Shariah.

Gharar: Uncertainty or speculation.
Ijarah: Leasing.
Islam: Submission or surrender to the will of God.
Kafaluh: Guarantee
Mudarabah: Investor-entrepreneur profit sharing contract
Mudarib: Entrepreneur.
Murabahah: Cost plus mark-up sale
Musharakah: Joint venture profit and loss sharing
Qardh al-hassan: Benevolent or interest-free loan.
Quran: The holy Book of the Muslims consisting of the revelations made by God to the Prophet Muhammad, peace be upon him (pbuh). The Quran lays down the fundamentals of the Islamic faith, including beliefs and all aspects of the Muslim way of life. In all references to the Quran in the text (20:45), the first number refers to the surah or chapter and the second refers to the ayat or verse.

RabbulMal: Beneficial owner, the owner of capital or financier in a mudarabah partnership agreement.
Riba: A ‘premium’ that must be paid by the borrower to the lender along with the principal amount as a condition for loan. It is equivalent to interest.

Shari’ah: Refers to the divine guidance as given by (i) the Quran (the original source form which all principles and ordinances of Islam are drawn, (ii) the Sunnah (the sayings and actions of the Prophet, (iii) the Ijihad (exercise of judgement based on the Quran and Sunnah and (v) the Ijma’ (the legal consensus).

Wadiah: Safe custody or deposit.
Wakalah: Agency
Zakat: The amount payable by a Muslim on his networth as a part of his religious obligations, mainly for the benefit of the poor and the needy.
CHAPTER ONE

INTRODUCTION

1.1 Introduction

The development of Islamic banks in Malaysia has been proven with several benchmarks. Among those are the percentage of Islamic banking assets from the total assets in banking industry, the number of Islamic banking institutions and the wide range of financial instruments introduced by Islamic banks. The rapid growth of Islamic banking industry is supported by many factors especially strong government supports and prudent regulatory frameworks. The industry has been recognised as one of the emerging sectors in the Malaysian economy.

In line with the development of universal banking stature, Islamic banks are permitted to offer various forms of banking products and services ranging from the more sophisticated investment banking activities such as corporate finance and private equity management to a variety of wealth management services in the vein of unit trusts and structured products for customers. At the same time, conforming with the World Trade Organisation (WTO) requirements, and as part of the liberalisations of financial services, foreign participants are also allowed to take part in Malaysia to promote the growth of the Islamic banking industry.
The contents of the thesis is for internal user only
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