FACTORS INFLUENCING CORPORATE SOCIAL RESPONSIBILITY DISCLOSURE BY ISLAMIC BANKS

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ABSTRACT

The existing literature on corporate social responsibility (CSR) disclosure in the context of Islamic banks has focussed only on the extent and nature of CSR, rather than on factors influencing the level of CSR disclosure. This study investigates the types and extent of CSR information disclosure in 132 annual reports of Islamic banks from different countries for the year 2008 using a benchmark based on *Shariah* principles and rules. It also examines the impact of corporate governance (CG) mechanisms, consisting of the board of directors' effectiveness (BODE), the effectiveness of *Shariah* supervisory board (ESSB), the audit quality (AUDITQ), and the overall score of CG on the CSR disclosure level based on legitimacy theory. The study uses content analysis and ordinary least square regression to achieve the research objectives. The findings show that there is an increase in disclosure of CSR information. The ranking of CSR disclosure themes (from highest to lowest) is as follows: (1) top management, (2) products and services, (3) Employees, (4) *Shariah* supervisory board (SSB), (5) customers, (6) late repayments and insolvent clients, (7) other aspects of community involvement, (8) vision and mission statement, (9) poverty, (10) *Zakah*, (11) charitable and social activities, (12) unlawful transactions, (13) *Quard Hassan*, and (14) the environment. As for the BOD, the results show that only the board composition has a negative impact on CSR disclosure. Regarding the SSB, cross-memberships are positively associated with CSR disclosure, whilst for the AUDITQ, the members with an accounting degree, the percentage of non-executive directors and the meetings' frequency are found to influence the CSR disclosure. The findings also show that SSBE and AUDITQ significantly influence the CSR disclosure, while BODE has no influence at all. The overall score of CG also significantly influences the CSR disclosure.

Keywords: Islamic banking, corporate social responsibility disclosure, corporate governance mechanisms, legitimacy theory

ABSTRAK

Kajian literatur yang sedi ada mengenai penzahiran tanggungjawab sosial (CSR) korporat dalam konteks bank-bank Islam lebih menumpukan kepada tahap dan sifat CSR, dan bukannya faktor-faktor yang mempengaruhi tahap penzahiran CSR. Kajian ini menyelidiki jenis dan tahap penzahiran maklumat CSR dalam 132 laporan tahunan bank-bank Islam dari pelbagai negara bagi tahun 2008 dengan menggunakan penanda aras berdasarkan prinsip dan peraturan Syariah. Ia juga mengkaji kesan mekanisme tadbir urus korporat (CG) ke atas tahap penzahiran CSR berdasarkan teori legitimasi. Selain itu, ia juga menguji pengaruh keberkesanan lembaga pengarah (BODE), keberkesanan lembaga pengawasan Syariah (ESSB), kualiti audit (AUDITQ), dan kesan skor keseluruhan CG ke atas tahap penzahiran CSR berdasarkan teori legitimasi. Kajian ini menggunakan analisis kandungan dan regresi kuasa dua terkecil biasa untuk mencapai objektif kajian. Hasil kajian menunjukkan bahawa terdapat peningkatan dalam maklumat CSR. Kedudukan tema penzahiran CSR (dari yang tertinggi ke terendah) adalah seperti berikut: (1) pihak pengurusan atasan, (2) produk dan perkhidmatan, (3) pekerja, (4) lembaga pengawasan Syariah (SSB), (5) pelanggan, (6) kelewatan pembayaran balik dan pelanggan yang tidak mampu bayar, (7) lain-lain aspek penglibatan masyarakat, (8) pernyataan visi dan misi, (9) kemiskinan, (10) zakat (11) aktiviti kebajikan dan sosial, (12) urus niaga yang menyalahi undang-undang, (13) *Quard Hassan*, dan (14) alam sekitar. Seterusnya, tidak semua pembolehubah CG adalah signifikan. Penemuan menunjukkan bahawa hanya nisbah pengarah bukan eksekutif mempunyai kesan negatif ke atas penzahiran CSR. Mengenai SSB, keahlian bersilang didapati berkait secara positif dengan penzahiran CSR. Bagi AUDITQ pula, ahli-ahli jawatankuasa audit yang mempunyai ijazah perakaunan, peratusan pengarah bukan eksekutif dan kekerapan mesyuarat didapati mempengaruhi penzahiran CSR. Selain itu, dapatan kajian juga menunjukkan bahawa SSBE dan AUDITQ memberi kesan yang signifikan ke atas penzahiran CSR, manakala keberkesanan lembaga pengarah tidak mempunyai sebarang pengaruh. Skor keseluruhan CG juga mempengaruhi penzahiran CSR.

Kata Kunci: Perbankan Islam, Penzahiran Tanggungjawab Sosial Korporat, Mekanisme Tadbir Urus Korporat, Teori Legitimasi

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AAOIFI	Accounting and Auditing Organization for Islamic Financial Institutions
AC	Audit Committee
ACACC	Accounting or Financing Degree of the Audit Committee Members
AIDS	Acquired Immune Deficiency Syndrome
AUDIT	Auditor Type
AUDITQ	Audit Quality
BCBS	Basel Committee on Banking Supervision
BIMB	Bank Islam Malaysia Berhad
BMI	Bank *Muamalat* Indonesia
BOARD	Board of Directors' Effectiveness
BODE	Board of Directors Effectiveness
BODs	Board of Directors
BSIZE	Bank Size
CEO	Chief Executive Officer
CG	Corporate Governance
CGSCORE	Corporate Governance Score
CHAIRP	Chairperson Position
CROSS	Cross-memberships of *Shariah S*upervisory Board Members
CSD	Corporate Social Disclosure
CSR	Corporate Social Responsibility
CSRD	Corporate Social Responsibility Disclosure
DBS	Development Bank of Singapore
EII	Ethical Identity Index
ESSB	The effectiveness of Shariah supervisory board
IAHs	Investment Account Holders
IAIB	International Association of Islamic Banks
IASC	International Accounting Standards Committee
ICD	Intellectual Capital Disclosure
ICDI	Intellectual Capital Disclosure Index
ICWC	Intellectual Capital Word Account
IFH	Ihlas Finance House
IFSB	Islamic Financial Services Board
INDs	Independent Non-Executive Directors
KLSE	Kuala Lumpur Stock Exchange
MB	Market to Book Value
MEET	Meetings Frequency of the Audit Committee
MUSP	Proportion of Muslim Population to Total Population
NAC	Number of the Audit Committee
NEAC	Non-Executive Directors on the Audit Committee
NEBOD	Proportion of Non-Executive Directors to Total Directors on the Board
NED	Non Executive Directors

NSSB	Number of *Shariah* Supervisory Board
OECD	Organization for Economic Co-operation and Development
OLS	Ordinary Least Square
OSHIP	Ownership
PENED	Proportion of Expert Outside Directors on the Board
PERFOR	Performance
PHD	Doctor of Philosophy of Shariah Supervisory Board Members
PNED	Proportion of Non-Executive Director on the Board
ROA	Return on Assets
ROE	Return on Equity
REP	Reputable Scholars on the S*hariah* Supervisory Board
R & D	Research and Development
SCEO	Separation role of CEO and chairman
SSB	*Shariah* Supervisory Board
SSM	Saudi Stock Market
UAE	United Arab Emirates
UK	United Kingdom
US	United States
VIF	Variance Inflation Factors

GLOSSARY OF ISLAMIC BANKING TERMS

Bay'al-salam	Pre-paid purchase. Full payment is made in the time of purchase, while the delivery of goods is deferred to a specified time.
Gharar	Uncertainty, speculation.
Hadith	The sayings, doings, and traditions of the Prophet.
Halal	Legal.
Haram	Unlawful.
Ijarah	Leasing contract whereby an Islamic bank buys an asset for a client and then leases it back over a specific time.
Ijarah-wa-igtina	Similar to *Ijarah* except that the client is able to purchase the asset at the end of the agreement.
Mudharabah	Trustee financing contract, where an Islamic bank (the financier) entrusts funds to the other party (the entrepreneur) for carrying out an investment.
Murabahah	Resale with profit margin; an Islamic bank buys an asset and sells it to the customer on the basis of a cost plus profit margin.
Musharakah	An equity partnership contract whereby two or more partners participate with funds to undertake an activity.
Prophet Muhammad	The last messenger to the human-being.
Quard Hassan	Benevolent loan (interest-free).
Qur'an	The Holly Book, the revealed word of *Allah* (God), followed by all Muslims.
Riba	Literally "increase" or excess" that includes both usury and interest.
Sadaqah	Voluntary religious charity.
Shariah	Islamic religious law derived from the Holly *Qur'an* and the *Sunnah.*
Shariah Supervisory Board	The committee of Islamic scholars setting on an Islamic financial institution for guidance and supervision in the development of *Shariah* compliant products.
Sunnah	Source of information regarding the practice of Prophet Muhammad and his Companions; the second source of Islamic law.
Ummah	The Islamic community.
Zakah	Mandatory religious levy and one of the five pillars of Islam.

CHAPTER ONE

INTRODUCTION

1.1 THE INCREASE OF CORPORATE SOCIAL RESPONSIBILITY

According to Reverte (2009), the last few decades have witnessed an increase in public awareness about the importance of corporate social responsibility (CSR). The importance of CSR arose due to the growth in communication between various stakeholder groups and business organizations in society. The growing communication reflects the accountability of corporations in meeting their stakeholders' needs (Gray, Kouhy, & Lavers, 1995a).

Nowadays, CSR is one of the important success factors for business organizations desiring to continue their existence with a good reputation, toward achieving maximum profitability and improving corporate growth, and at the same time acting as a socially responsible enterprise. This means that an organization should be held responsible for any of its activities that have an effect on citizens, communities, society at large, and the environment (Gustafson, 2002). With this concept, Islamic business organizations such as Islamic banks provide CSR information to show their responsibility and accountability towards society and towards *Allah* (Muwazir, Muhamad, & Noordin, 2006); and for their continued existence (Farook & Lanis, 2005); so they have to be seen as social enterprises (Maali, Casson, & Napier, 2006).

Companies use CSR as a strategic weapon for competition in the era of globalization (Will, 2007). Because of the increasing importance of the impact of CSR, corporations should consider what they can do for society. This meaning is supported by Waddock (2005), who put forth the question, "what are a company's responsibilities to society"? And it is consistent with the main objective of social performance, which aims to determine the impact of a business organization's activities on the quality of life in their society (Daykin, 2006).

Recently, several studies have documented an increased interest in CSR, and the need for corporations to behave in a socially accountable way and this phenomenon has become a general requirement of any society. Blomback and Wirgen (2009) pointed out that one reason for corporations to engage in CSR activities is because of societal pressures. Similarly, Haniffa (2002) argues that Islamic business organizations provide CSR information to align with public expectations (*Ummah*).

In terms of the Islamic context, the concept of CSR refers to the principles of accountability before *Allah*, the role of mankind as a vicegerent on the earth (*Khalifah*), the concept of monotheism (*Tawheed*), social justice and responsibility. These principles are the main ethical principles in Islam which further impose broader social duties on both Muslim individuals and organizations (Asutay, 2007; Kamla, Gallhofer, & Salam, 2006; Maali *et al.*, 2006; Rice, 1999; Sairally, 2007). Consequently, based on *Shariah* rules and principles, business transactions must comply with moral objectives of the society and be free from all kinds of exploitation (Farook & Lanis, 2005). Derived from this viewpoint, Islamic banks have to ethically operate in conformity with Islamic principles. The prevention of *riba* (usury) is one of the major contributing principles that reveals the social responsibility of Islamic banks. The adoption of such principles will create a social interaction among Islamic banks to engage in CSR. This social role is very important to Islamic banks because they have been characterized as having “a social face” (Maali *et al*., 2006), and it reflects the Islamic moral obligations of Islamic banks that are influenced by the *Ummah* in which they operate (Farook & Lanis, 2005; Maali *et al*., 2006).

Many scholars have developed a normative approach for an Islamic entity (Baydoun & Willet 2000; Lewis 2001) and social reporting for Islamic financial organizations based on the *Shariah* principles and rules (Haniffa, 2001; Maali *et al*., 2006). International regulatory institutions such as the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and governments in Muslim-populated countries like Malaysia have voiced their support for the adoption and development of such CSR reporting standards (Farook & Lanis, 2005) and many Islamic banks have adopted the standards that have been set by AAOIFI.

There is evidence in recent years that companies have considerably increased their disclosures related to CSR in their annual reports to meet the increased interest from different stakeholder groups such as creditors, employees, consumers, and politicians and shareholders in making the right decisions (Brammer & Pavelin, 2004; Gray, Javad, Power, & Sinclair, 2001). This point is consistent with the main objective of corporate social reporting by Islamic business organizations which is to disclose all information necessary to the stakeholders about their transactions that are in compliance with *Shariah* (Farook, 2007).

Previous studies have examined the influence of corporate governance variables on CSR disclosure (Haniffa & Cooke, 2005). Other studies have investigated the impact of just one or two governance mechanisms such as ownership structure and board of directors on CSR disclosure (e.g., Halme & Huse, 1997; Khan, 2010; Rashid & Lodh, 2008; Said, Zainuddin, & Haron, 2009). However, there are very sparse studies that have provided empirical evidence on CSR disclosure based on *Shariah* principles (Farook & Lanis, 2005; Othman *et al.*, 2009). This study seeks to improve the understanding of CSR disclosures in the annual reports by examining corporate governance attributes in the Islamic banking industry.

1.2 BACKGROUND OF THE STUDY

According to Raynard and Forstater (2002), the last two decades have witnessed a fundamental alteration in the relationship between the organization of businesses and society. The main factors of this alteration have been the globalization of trade, the improved size and influence of corporations, the repositioning of governments and the increase in the significance of policies related to the stakeholders' relationships, experience and trade name. This is because CSR has become an important aspect of managing business (Aguilera *et al.*, 2007; Hummels, 2004; Mackey, Mackey, & Barney 2007; Peloza, 2005).

There is also an increased concern of CSR practices from academics, governments, professional bodies, industries, corporations, and multiple stakeholders including shareholders (Brammer & Pavelin, 2004; Ghazali, 2007; Perera, 2007). CSR practice is seen as providing a solution to improve accountability for societal issues (Hall, 2002). This point is consistent with the role of Islamic banks that are assumed to encourage sustainable economic growth based on the principle of social justice and the welfare of the community (Dusuki & Dar, 2005; Khan & Bhatti, 2008; Usmani,

2002) with the objective of eliminating poverty (Sairally, 2007). Islamic banks can also achieve their responsibilities within societies by implementing new financing strategies and to look for further means of investment that may promote the development of small-scale traders among the poor.

Corporate governance has become a vital subject through the last twenty years (Chapra & Ahmed, 2002). This is because the recent high incidence of corporate collapses such as Enron, WorldCom, HIH Insurance, and Global Crossing together with the increased global awareness of the need for sound corporate governance based on stakeholder's accountability and financial transparency (McLaren, 2004). In this regard, Islamic financial institutions are not spared from this phenomenon since the breakdown of Ihlas Finance House (IFH) of Turkey in 2001 and it shows that the extent of corporate governance practices among Islamic financial institutions is still weak (Dusuki, 2006a).

The tenets of legitimacy theory suggest that corporations operate in a society based on a social contract where it expects to achieve diverse socially-needed activities in return for support of its goals (Donaldson, 1982; Lehman, 1983). The role of management is not only to provide social information to shareholders and other stakeholders, but also to comply with the "social contract" through disclosing information that is aligned with the expectations of society (Farook & Lanis, 2005) as well as to resolve problems arising from potential conflicting responsibilities among different stakeholder groups (Dusuki, 2006a). Social disclosure in broad terms consists of a corporation's relationships with various stakeholders that include investors, creditors, employees, suppliers, customers, government and community

(Epstein & Freedman, 1994). This is supported by Farook and Lanis (2005) who pointed out that the disclosure of CSR information is based on the relationship between the corporation, government, individuals, stakeholders and primarily the Islamic society (*Ummah*). Accordingly, CSR is defined as "including the concern for the impact of all of the corporation's activities on the total welfare of society" (Bowman & Haire (1976) cited by Farook & Lanis, 2005, p. 8). From this definition, a corporation continually seeks to ensure that its activities within the boundaries and norms of their respective society (Deegan, 2002).

The concept of CSR in Islam is similar to the concept of "social contract", whereby the value system of an organization has its origin in the greater value system of an Islamic society (Farook & Lanis, 2005). Islamic banks legitimize their actions by disclosing relevant CSR information to justify their continued existence (Farook & Lanis, 2005; Maali *et al.,* 2006).

Corporations try to communicate enough CSR information primarily to the various stakeholders and society at large to enable these users to evaluate whether it is a good corporate citizen (Guthrie & Parker, 1989). According to Lambert, Kass, Piotrowski, and Vodanovich (2006), corporate actions affect the quality of life of citizens in the societies in which those corporations operate. CSR from the Islamic perspective refers to the obligations that Islamic financial institutions such as Islamic banks have to protect and contribute to the society in which they operate (Muwazir *et al*., 2006). Previous studies found that the disclosure of CSR information is highest among "environmentally sensitive sectors (such as manufacturing sectors, resources, utilities, and chemicals), and those sectors with a close relationship to consumers (such as banking, food/drink, media, and retailing)" (Brammer & Pavelin, 2004, p. 94).

Lately, stakeholders have become more aware of a corporation's social performance, (Haigh & Jones, 2006). In other words, they have become more knowledgeable of the effect of business activities on their welfare. From an Islamic perspective, Islamic business is characterized by the ethical norms and social commitments that are grounded on the moral and ethical structure of *Shariah* (Dusuki, 2006b). Islamic financial transactions are required to operate according to the *Shariah* principles and rules that require all activities to be ethically and socially responsible, and that prohibit participation in unlawful transactions, or those that are harmful to the social and environmental welfare.

There is evidence that shows shareholders and other potential stakeholder groups rely on the annual reports as the prime and reliable source of corporate information in making their decisions (Harahap, 2003). Financial reporting from an Islamic perspective should include more information about responsibility, accountability and transparency beyond society to include *Allah* and the environment (Muwazir *et al.*, 2006). Since social reporting is one of the corporate reporting of Islamic business organizations like Islamic banks, it plays an important role for many Muslim stakeholders, particularly for the Muslim decision-makers (Othman *et al*., 2009).

Many studies have investigated social issues for centuries, but most of those studies have been conducted in Europe and the United States, and based on Western values and cultures (Birch, 2003; Birch & Moon, 2004; Carroll, 1999; Waddock & Smith, 2000; Welford, 2005). However, no serious attempt has been done to study CSR from an Islamic perspective (Dusuki, 2008). According to Milne (2007), social research accounting should concentrate on the extent of disclosure, relationships between disclosure and other variables (e.g., size of the industry, market price), the audit of disclosures, and other variables.

In the context of Islamic banks, few studies have been conducted on CSR practices (e.g., Abdeldayem, 2009; Farook & Lanis, 2005; Hudaib & Haniffa, 2007; Maali *et al*., 2006). Most of those studies regarding CSR have been descriptive in nature. Only one study (Farook & Lanis, 2005) has examined the impact of Islamic corporate governance variables on the level of CSR disclosure by Islamic banks and they contended that future research should examine more characteristics of the *Shariah* supervisory board and other determinants that may affect the extent of CSR disclosure by Islamic banks. This result is supported by Khan (2010) who suggested that future researchers should extend this kind of research to assess the impact of corporate governance on CSR reporting practices in the banking industry.

Due to demand for CSR information, the wide variation of CSR reporting context and limited research on the disclosure of CSR information by Islamic banks, this study is quite timely to gain insights into actual CSR disclosure practices by Islamic banks. CSR disclosure in the context of Islamic banks contains many themes, such as *Shariah* board, unlawful transactions, *Zakah*, charitable and social activities, products and consumers, and human resources which are now becoming more important to the Islamic community. The themes that make up CSR disclosure are important because the disclosure level will always vary according to the theme. By examining the linkage between CSR disclosures and corporate governance mechanisms, it will provide evidence as whether the present theories of CSR disclosure are appropriate for explaining such disclosures for Islamic business enterprises.

1.3 The Development of Islamic Banking

Islamic banks are defined as those banks that follow the *Shariah* rulings in all types of business transactions (Maali *et al*., 2006). The *Shariah* requires that all business transactions be legal (*halal*) and forbids any types of businesses that include interest (*riba*) as well as to be free from any types of speculation. It also requires all Muslims, individuals and organizations to pay religious tax (*Zakah*). By doing so, the principle of social justice will be achieved in Muslim society.

In the last three decades, Islamic banking has emerged as one of the fastest-growing industries in terms of size with an annual growth rate of 12-15% or higher (Rogers, 2004; Zaher & Hassan, 2001). In fact, the efforts towards the establishment of Islamic banks were started in the 1940s (Laldin, 2008). Further, the development of Islamic banks took place in the 1970s with the establishment of the Nasser Social Bank Cairo (1972), Islamic Development Bank (1975), Dubai Islamic Bank (1975) as the first commercial banks, Kuwait Finance House (1977) and Faisal Islamic Bank of Sudan (1977). There are many factors that contributed to the development of Islamic banks which include political, economic and demographic elements, the effect of the Iranian revolution, an increase in the Muslim middle class group, the growing of Asian tigers, improved deregulation and the oil crisis in the 1970s (Farook & Lanis, 2005).

The 1990s were considered a new era for the industry when the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) was established to set accounting, auditing, governance, and ethics standards for Islamic financial institutions based on the *Shariah* rules and principles. These standards gave confidence to Muslim investors to engage in banking investments. Consequently, at the end of 2008, there were more than 300 Islamic banks operating in over 70 countries throughout the world with a capital size in excess of US$ 500 billion (Khan & Bhatti, 2008).

The last ten years have witnessed the amazing growth of Islamic banks from 176 in 1997 to more than 300 at the end of 2008 (see

1.1).

Table 1.1
The Development of Islamic Banking from 1997 to 2008

Year	1997	2000	2004	2005	2008
Number of banks	176	200	267	284	Over 300
Assets worth in $US billions	112.6	Over 160	250	300	Over 500

Source: Bahrain Monetary Agency (2004), Laldin (2008), Dusuki (2008), Khan and Bhatti (2008).

The Islamic banks have extended and diversified their activities to all over the world and received broad acceptance by both Muslims and non-Muslims (Iqbal & Molyneux, 2005). By 2010, Islamic banking had managed a market value of US$4 trillion (Khan & Bhatti, 2008). This growth parallels the growth of Islamic banking at the international level.

According to Khan and Bhatti (2008, p. 42), Islamic banking is considered as "an equity-based system featuring zero-based interest, share economy, equity participation, joint ventures, mutual funds, leasing, innovation, and a promising rate of return. The main unique characteristic of Islamic banks is that they do business with feeble groups and the needy". They offer financing for small- and medium-sized business organizations to support sustainable economic growth with fairness. They collect charitable funds and donations from their shareholders, customers and others to give these funds to the poor and disadvantaged groups in Muslim society based on religious and social responsibility. In some aspects, the major activities of Islamic banking are quite similar to mutual funds in the West which demonstrate their activities to fulfil their ethical and social responsibilities based on their own beliefs. The main difference is that Islamic banks are based on *Shariah* which includes all dealings, transactions, business approaches, product characteristics, investment concentrations, and CSR which are derived from the *Shariah* principles. Another key differentiating factor is that Islamic banks embrace the concept of partnership, profit sharing and value added between the banker (financier) and client. In addition, the concepts of *Zakah* (religion tax), *Sadaqah* (voluntary charity) and *Quard Hasan* (free loan) have played a significant function in improving the welfare of Muslim communities. The principle of Islamic banking operation is based on the Islamic faith, which is one of the least understood religions in the West and all transactions must be consistent with *Shariah* which means the way of life prescribed by *Allah* through the Prophet Muhammed. The *Qur'anic* teachings and the practices of the Prophet, called the *Sunnah*, make up the *Shariah* (Chapra, 2000).

1.4 STATEMENT OF THE PROBLEM

The concept of CSR practices is one in which corporations are not only responsible for more than achieving their financial goal for a particular interest group within a society, but also to achieve social and environmental objectives for the community at large (Norman & MacDonald, 2004; Schafer, 2005). This is in line with the Islamic viewpoint that puts social responsibility as the main objective of Islamic financial institutions (Ahmed, 2000). Recently, CSR disclosure was considered as one of the operational tools by which a company can focus on social responsibility. CSR disclosure is also a communication tool of the organization's social impact through corporate annual reports, or separate social reports. In addition, CSR disclosure plays an important function in enhancing a corporation's transparency, developing a corporation's image, and giving useful information for making the right investment decision (see, for example, Gray *et al*., 1995a; Patten, 1990).

The recent collapses of corporations such as Enron, WorldCom, HIH Insurance, Global Crossing and IFH in 2001 indicated the importance of having good corporate governance standards or guidelines for financial and non-financial institutions in both Islamic and non-Islamic countries. As a result, many international organizations, such as the Organization for Economic Co-operation and Development (OECD), the Basel Committee on Banking Supervision (BCBS), the Accounting and Auditing Organization for Islamic financial institutions (AAOIFI), and the Islamic Financial Standards Board (IFSB) have issued certain sets of these standards or guidelines.

From the literature review, it is apparent that different theories consisting of agency theory, political economy theory, legitimacy theory and stakeholder theory, have been used by researchers to explain why corporations disclose CSR information (see, for instance, Deegan, 2002; Deegan & Rankin, 1996; Guthrie & Parker, 1989).

These theories have been developed primarily from an Anglo-Saxon or European perspective. The use of theories to clarify disclosure practices in a diverse political, economic, and social setting is debatable (Hofstede, 1981, 1983; Perera, 1989; Ali, 1996; Ahmed, 2004). In this respect, Adams and Harte (1999), Gray *et al*. (1996) and Milne and Chan (1999) stated that there is no universally-accepted theoretical framework for CSR disclosure. Mathews (1997) gives attention to the need for additional research to investigate, for example, whether the current theoretical framework can be used to demonstrate social and environmental disclosure information in other cultures.

Furthermore, most of the empirical studies of CSR are focused in European and American countries, and based on Western values (see, for example, Birch, 2003; Birch & Moon, 2004; Guthrie & Parker, 1990; Roberts, 1992; Welford, 2005). It is apparent that less consideration has been given to CSR in other cultural and religious (such as Islam) settings, thus creating a gap in the literature. In contrast with Western countries, where religion is seen to be separate from the state, to Muslims, in addition to being a religion, Islam is also viewed as a way of life that governs all aspects of life including politics, economy, and business daily practice as well. Islamic business values of justice, human welfare, and socio-economic measures are the primary principles of CSR.

Studies that have examined the factors influencing the disclosure level of CSR have concentrated on a firm's characteristics as the determinants of the disclosure level of CSR. However, few studies have investigated the association between CSR disclosure and corporate governance mechanisms, such as board characteristics, ownership structure, and audit committee or general governance variables (Halme & Huse, 1997; Haniffa & Cooke, 2005; Rashid & Lodh, 2008; Said, Zainuddin, & Haron, 2009).

The majority of the international studies on CSR disclosure have concentrated on the non-financial sectors. Few studies have focused on the banking industry (Branco & Rodrigues, 2006, 2008b; Hamid, 2004; Khan, 2010). However, there are some studies that have provided evidence on CSR disclosure by Islamic banks (Abdeldayem, 2009; Farook & Lanis, 2005; Haniffa & Hudaib, 2007, Maali *et al.*, 2006). In contrast to expectations of full disclosure and accountability, the low disclosure level showed by previous studies of Farook and Lanis (2005) and Maali *et al.* (2006) by Islamic banks is one reason why this research is being done to investigate the current CSR disclosure practices by this sector.

Previous CSR studies in the context of Islamic banks concentrated on the extent and nature of CSR rather than the factors influencing the disclosure level of CSR. Most of these studies were descriptive or analytical in their nature. One study by Farook and Lanis (2005) examined the determinants of the disclosure level of CSR. This study suffered from a number of limitations. First, it provided a determinant model based only on Islamic corporate governance attributes as determinants of CSR disclosure while ignoring other corporate governance mechanisms such as the board of directors and audit committee. Second, its sampling size, themes, and items were small. Third, it used the same disclosure index that was developed by Maali *et al.* (2003). Fourth, it did not give a deep picture related to the types and extent of actual CSR practices.

The present study attempts to overcome these limitations by extending the application of legitimacy theory to improve the understanding of the determinants of CSR disclosure in the annual reports of Islamic banks. Within the framework of legitimacy theory, the study examines the relationship between corporate governance mechanisms and the disclosure level of CSR. The study measures corporate governance using new variables including board of directors' characteristics, *Shariah* supervisory board attributes and audit quality, including audit committee characteristics and audit company size. There is evidence that a firm with stronger governance tends to be more transparent and discloses information at a higher level (Beekes & Brown, 2006; Ajinkya *et al*., 2005). The attributes of corporate governance are chosen from the Code of Best Practices for Corporate Governance in Islamic financial institutions (Chapra & Ahmed, 2002); Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services (IFSB, 2006); and AAOIFI standards (2005), since the corporate governance framework under Islamic banks is quite different from conventional banks.

In summary, the current study seeks to fill the gaps in the literature by examining the influence of corporate governance mechanisms on the CSR disclosure level using new variables under legitimacy theory from an Islamic perspective. Derived from legitimacy theory, the extent of a corporation's CSR disclosure is a response to community pressures which are represented by the factor for the socio-political context, relevant public. The empirical evidence showed that the "relevant public" is the most important determinant of CSR that appears to be directly related to the management (Newson & Deegan, 2002). In the case of Islamic banks, the main "relevant public" is the society. The relative size of the Muslim population as a measure for the public pressure from the Islamic community (*Ummah*) will determine the extent of CSR information disclosed in annual reports of Islamic banks. As mentioned above, the new variables comprise board of directors' effectiveness (board composition, the separation of CEO and chairman's role, and the independence of the chairman), effectiveness of SSB (the existence of SSB, number of board members, cross membership, secular educational qualifications, and reputability), and audit quality (the existence and composition of an audit committee, the frequency of audit committee meetings, the expertise of audit committee members, and audit firm size), as well as relative size of Muslim population. These fourteen variables of corporate governance (in combination) have never been used in prior studies in the area of CSR disclosure. An examination of this issue will provide further insights on whether the determinants found to be an influence on corporations in other industries can be applied in the Islamic banking industry.

In addition, the study adds two new themes, namely, customer and poverty which have not been used in the CSR disclosure index of previous studies by Islamic banks, and it uses a large sample in order to reduce the sampling error that may affect the findings of a study (Orlitzky, Schmidt, & Rynes, 2003).

Furthermore, the study goes deeply in the two-dimensional analysis, namely, conceptual analysis and content analysis based on *Shariah* principles and rules in seeking much more than the Islamic accounting literature, in order to understand CSR disclosure in the Islamic banks.

1.5 RESEARCH OBJECTIVES

The major objective of this study is to examine the types and extent of CSR disclosure in the annual reports of a large sample of Islamic banks around the world based on an Islamic perspective and according to the *Shariah* principles and rules. The present study also measures the influence of corporate governance mechanisms on CSR disclosure by Islamic banks using legitimacy theory as the theoretical framework. Consequently, the research will attempt to attain the following objectives:

1. To identify the types and extent of CSR information disclosure in the annual reports of Islamic banks around the world using a benchmark based on *Shariah* principles and rules.
2. To examine the relationship between the socio-political context factor, relevant public (size of Muslim population) and the disclosure level of CSR in the annual reports of Islamic banks.
3. To examine the relationship between corporate governance variables (board composition, the separation of CEO and Chairperson, the position of Chairperson, the existence of a *Shariah* supervisory board (SSB), number of SSB, cross memberships of SSB, reputable SSB members, the qualifications of SSB members, the presence of an audit committee, composition of an audit committee, the frequency of audit committee meetings, expertise of audit committee members, audit firm size) and the level of CSR information disclosure.

4. To examine the impact of board of directors effectiveness, effectiveness of SSB and audit quality on the CSR disclosure level.
5. To examine the relationship between the overall score of corporate governance factors and the CSR disclosure level.

1.6 RESEARCH QUESTIONS

To achieve the above objectives, the following research questions are developed:

1. What are the types and extent of CSR information disclosure among Islamic banks?
2. Does the relevant public (size of Muslim population) influence the disclosure level of CSR?
3. What are the corporate governance variables that may influence the level of CSR disclosure?
4. Does the board of directors' effectiveness, the effectiveness of SSB and audit quality affect the level of CSR disclosure?
5. Does the score of the corporate governance elements affect the disclosure level of CSR?

These research questions are developed to add more clarity to the knowledge of CSR based on the *Shariah* principles.

1.7 MOTIVATIONS OF THE STUDY

The primary reason for conducting this study is that to the best of the researcher's knowledge, empirical studies concerning social responsibility disclosure by financial institutions such as Islamic banks are still sparse (see, for instance, Branco &

Rodrigues, 2006, 2008b; Douglas *et al*., 2004; Hamid, 2004; Haniffa & Hudaib, 2004). Secondly, most of the prior studies relating to disclosure studies have excluded banks or financial institutions in their sample because of different regulations attached to this sector as compared with other sectors (Cowen, Ferreri, & Parker, 1987; Gray *et al*., 1995a, 1995b; Gray, Javad, Power, & Sinclair 2001; Hackston & Milne, 1996). This study seeks to fill this gap by examining the nature and extent of CSR disclosure by Islamic banks because there is evidence that Islamic banks are not wholly fulfilling their social functions in compliance with the principles of *Shariah* (Aggarwal & Youssef 2000; Maali *et al*. 2006). Thirdly, this study tests the determinants of CSR disclosure from the framework of the so-called legitimacy theory that organizations employ to explain the ongoing relationship between the corporations, their stakeholders and the society (Roberts, 1992; Deegan, 2002). It examines also whether this theory can be used to clarify CSR disclosure by Islamic banks, to maintain their corporate legitimacy, for example, the societal acceptability of corporate activities (Deegan, 2002) in the context of Islamic banks. Finally, Griffin and Mahon (1997) suggested that future corporate social disclosure research needs to be conducted within a specific industry such as Islamic banks since their single industry has a set of unique characteristics. Also, there is evidence that studies on CSR disclosure have shown less focus on the disclosure practices of corporations in industries which have little or no environmental effects, such as banking and finance.

1.8 SCOPE OF THE STUDY

This study focuses on companies in one sector only, i.e., the banking industry. The study attempts to explore implications of CSR disclosure among Islamic banking organizations by reviewing the 2008 annual reports of a large sample of Islamic banks derived from a benchmark based on the Islamic perspective of accountability and social justice. In recent years, many Islamic banks have adopted CSR reporting standards that have been set by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). The extent to which the Islamic framework of CSR is implemented in practice was discussed based on a study of Islamic banks around the world. The following section discusses briefly the development of the Islamic banking industry.

1.9 CONTRIBUTIONS OF THE STUDY

The current study has a number of contributions to the knowledge:

First, this study is expected to provide new insights into the influence of corporate governance mechanisms on CSR disclosure using legitimacy theory from the Islamic perspective as suggested by prior researchers (see, for instance, Farook & Lanis, 2005). This sphere has not been examined in previous literature (Abdeldayem, 2009; Abdul Rahman, Hashim, & Abu Bakar, 2010; Haniffa & Hudaib, 2007; Maali *et al*., 2006; Muwazir *et al*., 2006). This study also contributes to the literature by developing a framework that connects the corporate governance elements with CSR disclosure, since the type of business differs from -culture to culture, and from one environment to another. This viewpoint is supported by Hofstede (1991), who asserts that theories are culturally trained and can never avoid being the result of the cultural environment of their authors, who do research and improve it.

Second, the study contributes to the literature in terms of methodology by developing an Islamic benchmark for CSR disclosure. This study extends the disclosure index that was used in studies by Haniffa and Hudaib (2007), Maali *et al*. (2006), and

Muwazir *et al*. (2006) by adding new themes, such as customers and poverty (Aribi & Gao, 2010; Sairally, 2007), because the literature supports the believe that these themes are critical as they can ensure Islamic banks to comply with *Shariah* rules. This study also adds some other disclosure items from the Islamic perspective, based on the review of literature from Aribi and Gao (2010), Haniffa and Hudaib (2007), and Sairally (2007). In addition, this study uses a relatively large sample to decrease the sampling error, which can affect the results of CSR analysis (Orlitzky *et al*., 2003).

Third, the study adds to the international literature by using a comprehensive set of corporate governance variables (14) are divided into three groups, namely, the board of directors' effectiveness, the effectiveness of SSB, and audit quality. These three groups together, plus the overall corporate governance score, have not been examined in previous studies, particularly within Islamic banks (see, for example, Barako & Brown, 2008b; Farook & Lanis, 2005; Haniffa & Cooke, 2005; Halme & Huse, 1997; Khan, 2010; Rashid & Lodh, 2008; Said *et al.*, 2009). In addition to the contribution of knowledge, the present study also contributes and adds to the current literature about social reporting practices. The study, consequently, avers that the management of Islamic banks seeks to improve their CSR disclosure by having members of SSB and audit committees with sufficient knowledge and skills regarding the banking sector, as well as the reasonable size of the board, and the good reputation of their members. This can be done by investing more in the banking controlling mechanisms to increase the confidence of investors, and all stakeholders in the society (Bakar, 2002).

In tandem with the global efforts to improve the working environment of the SSB, and to enhance audit quality (audit committee and external auditor) as well as to monitor more effectively the processes of Islamic bank reporting (see, for example, AAOIFI, 2005; IFSB, 2006), the findings of this study are of interest to both decision- and policy-makers. First, the results of the study will provide awareness on the importance of CSR disclosure in decision-making and support policy makers in developing guidelines and regulations appropriate to CSR disclosure practices for Islamic banks. The results should be of particular interest to Islamic bank regulators and policy makers to improve the integrity and transparency of their annual reports. Second, the results show that both the effectiveness of SSB and audit quality are related to CSR disclosure information, which is important for the assessment of the banks' market position to investors. Third, the findings provide a useful basis for both investors and analysts to evaluate the reliability of information published in the annual reports. Finally, the findings of this study provide strong evidence for regulators, such as AAOIFI and IFSB to identify the corporate governance standards that are more important in improving the reliability of CSR information. The empirical evidence of this study can be used to review the best practices of governance that exist in Islamic financial institutions. This is because the requirements for best practice of corporate governance should be derived from the results of empirical research rather than political discussions that are conducted in closed rooms. That would give the regulators sufficient and convinced justification to impose new corporate governance standards.

1.10 ORGANIZATION OF THE THESIS

Chapter One outlines the introduction which contains the background of the study, statement of the problem, research objectives, research questions, motivation of the study, and the scope of study together with the contribution of the study and organization of the thesis.

Chapter Two briefly describes the relevant review of literature related to the topics of the thesis and their similarities and differences with the current research. The theoretical framework of the study is included in this chapter.

Chapter Three describes the theoretical framework, which shows the relationships between corporate social responsibility disclosure and the independent variables of corporate governance mechanisms and firm characteristics, followed by hypotheses development.

Chapter Four explains the methodology of the research which includes the research method, research design, content analysis, the steps of conducting the reliability and validity tests of corporate social responsibility disclosure, the population and sampling and the measurement of the dependent and independent variables.

Chapter Five presents the findings of the descriptive statistics for the dependent variable (CSR disclosure). Further, it provides a descriptive analysis for the independent variables for both continuous and binary elements. In addition, it shows the association of CSR disclosure with the attributes of corporate governance by using both the Pearson and Spearman correlation matrixes. It also concludes the results of ordinary least square analysis for all variables separately and with the combination of board of directors, *Shariah* supervisory board and audit quality, as well as the score for overall governance characteristics, after considering all the necessary assumptions of the study.

Chapter Six gives a summary of the results of the study, and discusses the limitations of the study followed by recommendations for future research.

1.11 SUMMARY

This chapter gave an introduction to background of the study by focusing on the impact of corporate governance mechanisms on the CSR disclosure level in the annual reports of Islamic banks. Although many CSR disclosure studies are still concentrating on this area, the majority of studies to date have been conducted in conventional financial institutions and other industries.

This study aims to examine the relationship between the level of CSR disclosure in the annual reports of Islamic banks and corporate governance variables in order to achieve the research objectives and the contributions of the study.

The results of the study will be helpful, not only to the management of Islamic banks, Muslim inventors, and policy makers, but also for a diversity of stakeholders such as employees, creditors, customers, and the Muslim community at large.

CHAPTER TWO

LITERATURE REVIEW

2.1 INTRODUCTION

CSR disclosure refers to a corporation's achievement of societal responsibility to society as a whole. Particularly, it reflects how a corporation should conduct its operations that affect the quality of life for citizens in those societies. There are many stakeholders such as consumers, investors, employees, creditors, legislators and regulators who use social responsibility information to measure the impact of corporate activities within the society (Gray *et al*., 2001; Guthrie & Parker, 1990; Hackston & Milne, 1996; Othman *et al*., 2009). Nowadays, it is not enough for management to be accountable for the financial performance of firms to gauge a company's performance generally, but it should focus more on societal responsibility.

According to Othman *et al*. (2009), there are several reasons for firms to disclose corporate social information in their annual reports such as:

1- To provide a full picture of a firm to users of annual reports.

2- To decrease the chance of intervention by the government and societal restrictions on the firm.

3- To recognize that society has certain rights to information.

4- To serve as good public relations to report the firm's profits and costs.

5- To make the right decision, internally by management and externally by multiple stakeholders.

Although there are benefits of corporate social disclosure by firms, no definitive answers are seen as to why firms choose to disclose or not to disclose certain information, and also the extent and the format of such disclosures that would best serve the objectives of the corporation (Muwazir *et al*., 2006).

This chapter is structured as follows; the next section includes a brief historical picture of CSR, which comprises as well the concept of CSR from an Islamic perspective. Then, a synopsis of pertinent literature on the level and type of CSR disclosure by conventional financial institutions will be presented. Next, a review of CSR disclosure literature by Islamic financial institutions based on the context of *Shariah* rules and principles is explained. After that, a classification of CSR studies will be reviewed which includes the extent and level of CSR among conventional financial institutions and Islamic financial institutions as well as a review of the literature that focuses on corporate governance determinants of CSR disclosure. The final section of this chapter explains the underpinning theory.

2.2 CORPORATE SOCIAL RESPONSIBILITY (CSR)

In the context of a literature review, the objective of this study is to present a review of issues, viewpoints, theories and arguments on the current and continuing research conception of CSR. Although numerous documented research works on CSR have been presented so far, the study attempts to discuss the appropriateness of the present theories of CSR in explaining the CSR disclosure practices of Islamic banks and their relationship with some corporate governance mechanisms.

There is no commonly agreed-upon definition of CSR. However, it was believed that CSR originated from the efforts of Bowen in 1953 who wrote about the role of business and the extent of business's association with its interests as well as the needs of society (Windsor, 2001). Most researchers found that CSR is similar to corporate citizenship by businesses and businesses' operations influence society by bringing benefits to the firm and to society as a whole (Marsden & Andriof, 1998). Andriof and McIntosh (2001) suggested that CSR requires leaders of a company to understand that a company's activities have internal and external effects, either on the corporation itself, from its customers and employees to the communities and the environment.

All the above definitions have given birth to the concept of the "triple bottom line" that comprises the framework for measuring company's performance that is aligned with social, economic and environmental considerations.

Corporate social responsibility is not a new concept. In fact, it has existed since human-being existed on the Earth. In history, the activities of CSR are based on two concepts, paternalism and philanthropy (Keay, 2002). The concept of 'paternalism' of a corporation generally reflects the relationship between the employees with the employer while the concept of philanthropy is extended to the larger society. The concept of CSR has moved from "socially responsible business", to "corporate citizenship", and lastly, into the "triple bottom line".

According to Raynard and Forstater (2002), a number of researchers think CSR "introduces social and environmental clauses resulting in protectionism by the back door, imposes inappropriate cultural standards or unreasonably bureaucratic monitoring demands on small businesses, the net effect on the communities concerned will be a reduction in welfare" (p., 3). In contrast, CSR gives chances for larger market entrance, cost savings, productivity and innovation, and wider social usefulness like health and safety and improvements in society.

Business for Social Responsibility (BSR, 2000) defined CSR as "operating a business in a manner that meets or exceeds the ethical, legal, commercial and public expectations that society has of business". CSR is viewed by leadership firms as "more than a collection of discrete practices or occasional gestures, or initiatives motivated by marketing, public relations or other business benefits. Rather, it is viewed as a comprehensive set of policies, practices, and programs that are integrated throughout business operations and decision-making processes that are supported and rewarded by top management" (Katsoulakos & Katsoulakos, 2007, p. 13).

Recently, the World Business Council for Sustainable Development (WBCSD, 2010) defined CSR as:

> "the continuing commitment by business to contribute to economic development while improving the quality of life of the workforce and their families, as well as of the community and society at large".

There are many definitions of CSR that have been followed, and a more narrowed definition was given by the Industry Canada (2006):

> "the way in which firms integrate social, environmental and economic concerns into their values, culture, decision-making, strategy and operations in a transparent and accountable manner, and thereby establish better practices within the firm, create wealth, and improve society".

The CSR policy of a company is defined as the principles and processes that are aimed to minimize essentially its negative impacts and maximize positive impacts on the lives of the communities they work in (Maignan & Ralston, 2002). Actually, the concept of CSR is based on the changing relationship between business and society. According to Raynard and Forstater (2002), the CSR of a company operates on three levels.

Firstly, it must comply with legal responsibilities such as health and safety and employees' rights, as well as industry standards.

Secondly, it minimizes the negative effects of business on the welfare of society and manages risks.

Lastly, it maximizes the positive effects on the welfare of society by creating value through innovation, investment and partnership.

However, there is evidence that not all people accept that business has a social responsibility other than making a profit. This point is supported by Milton Freidman, who stated by asking a question “Should companies take responsibility for social issues?” to contribute in the creation of a general theory of CSR (Kok, Weile, McKenna, & Brown, 2001) and in 1970, Freidman also documented that “business as a whole cannot be said to have responsibilities”. He insisted that the business’s social responsibility is to create maximum profits by legal means through using its resources. This viewpoint has been agreed upon by the management of many corporations at that time, and the basic objective behind agency theory, as put by Jensen and Meckling in 1976, is that the motivations of management must be associated completely with those of shareholders, and the CEO and other managers must spend money only for generating profits.

2.3 EVOLUTION OF CORPORATE SOCIAL RESPONSIBILITY

Business has long been led by and followed the goal of profits, and a business corporation needs profits to grow and survive. Therefore, the maximization of profit as the sole ultimate goal for a business is not generally agreed upon (Freidman, 1962). The base year of 1953 was when Bowen published his landmark book 'Social Responsibilities of the Businessman', where he attempted to create a systematic concept of CSR. He also introduced an initial definition of CSR as the "obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of actions which are desirable in terms of the objectives and values of our society" (p. 6). Since Howard Bowen was the first researcher who tried to explain the meaning of CSR, Carroll suggested that Howard Bowen should be named the "Father of Corporate Social Responsibility" (Carroll, 2006, p. 5).

The concept of CSR has moved from the notion that a company has only economic and legal obligations to obligations to the society at large. In the 1960s, this idea became widely accepted and supported by many researchers, such as Joseph McGuire (1963), who stated in his book 'Business and Society': "The idea of social responsibilities supposes that the corporation has not only economic and legal obligations but also certain responsibilities to society, which extend beyond these obligations". Consequently, the CSR means that a company have obligations to the society and the environment, not just economic and legal obligations. At the end of the 1960s, many concepts of CSR had emerged, such as philanthropy, employee improvements, customer relations, and stockholder relations (Heald, 1970).

In the 1970s, the concept of stakeholders started because there was a need for defining who has responsibility and power in a company if it does not pursue those obligations of CSR to society. So, the first attempt to focus on the association between CSR and various shareholders was made by Wallich and McGuire (1970). This notion was supported by Harold Johnson (1971) in his book 'Business in Contemporary Society: Framework and Issues', that a responsible business considers employees, clients, suppliers, local societies, and the state instead of striving only for maximizing profits for its stockholders.

During the 1970s, the definition of CSR was extended and expanded when Milton Freidman (1970) explained the traditional role of business in his famous essay in the New York Times "The social responsibility of business is to increase its profits" (Wilcke, 2004). The viewpoint of Friedman was based on the assumption that all resources of the corporation must be used to maximize the wealth of shareholders through maximized profits. In contrast to this viewpoint, Carroll (1979) suggested that the principles of CSR included the primary economic responsibility, followed by legal and ethical responsibilities, and the final being philanthropic (discretionary) responsibilities as a voluntary category.

The 1980s witnessed efforts to define clearly what the responsibility of a company was by connecting different concepts of CSR such as corporate social responsibility, corporate social responsiveness, and corporate social performance. S. Prakash Sethi is one of the pioneer writers who invented distinctions among these concepts in his classic article in 1975. In 1984, Freeman published a book titled “Strategic Management: A Stakeholder Approach”. This theory focuses on the interactions between a company and its stakeholders such as employees, customers, creditors, and society at large. It is argued that there has been a demand for social performance from both society and stakeholders since the 1980s.

During the 1980s, the literature focuses on business ethics through understanding of the interconnections between business and society; consequently, literature on social issues in management has expanded. The concept of corporate conscience since the 1980s was developed by Kenneth E. Goodpaster at the Harvard Business School (Center for Ethical Business Culture, 2005). In 1986, William Frederick wrote about the conflicts between business and changing societal expectations. He is responsible for creating the foundation for connecting the field of business ethics and CSR.

Undoubtedly, in the 1990s the concept of corporate citizenship emphasized especially when Carroll (1991) stated that business organizations had four responsibilities simultaneously “strive to make a profit, obey the law, be ethical, and be a good corporate citizen” (p. 43). Carroll’s CSR pyramid comprised four dimensions of CSR. This pyramid set the economic responsibilities in the first place following by legal, ethical responsibilities, and lastly, corporate citizenship. The primary focus of any business organization has been on the economic responsibilities which aim to maximize the wealth of the shareholders through achieving profits. Legal responsibilities suggest that business organization should operate within the restrictions of laws, and it should comply with national policies. Ethical responsibilities, on the other hand, require business organizations to operate morally, fairly and justly (Tan & Komaran, 2006). However, business organizations should be good corporate citizens by using broadening accountability to achieve social welfare through financial contributions and other resources.

Based on Carroll's pyramid of CSR (1991), Lantos (2001) classified the CSR of a corporation into three responsibilities: ethical, altruistic, and strategic. Ethical responsibility is failing to fulfil at least the mandatory economic, legal, and ethical responsibilities of a corporation to its community. Lantos (2001) argued that strategic responsibility refers to the participation of a corporation in philanthropic activities that will effect on its benefit financially and the community's welfare positively through the responsibility of an altruism that is not legitimate. These two frameworks comprise a common notion that a corporation's actions affect the society where it operates. This view was supported by Wood (1991), who stated that "Business and society are interwoven rather than distinct entities" (p. 695).

2.4 CORPORATE SOCIAL RESPONSIBILITY FROM AN ISLAMIC PERSPECTIVE

Islam is in second place to Christianity in terms of number of followers, but it is the fastest-growing religion in the world with over one and a half billion Muslims (Khan & Bhatti, 2008). The Islamic message for human beings is complete in all aspects of political, economic and business life. In Islam, there is no separation between the spiritual and material needs. From this perspective, Islam (religion) is a representation of a "way of life" (Haneef, 2005), which impacts on the behavior of individuals, as well as organizations and the society as a whole.

From an Islamic viewpoint, the social responsibilities of individuals are based on the *Qur'an* (the speech of *Allah*) and the *Sunnah* (the Prophet Muhammad's deeds and sayings), as well as applying to business organizations. In addition, the establishing and existence of Islamic institutions are not arbitrary in business practices at the present time, which are supposed to follow the *Shariah* principles in practicing their businesses. Consequently, Islamic business organizations have two duties that are to be performed concurrently and no isolation is allowed according to their accountability (Maali *et al*., 2006; Muwazir *et al.*, 2006). The first duty is to be accountable before *Allah,* and accordingly, to society. Therefore, the accountability to *Allah* constitutes the framework of the social responsibility of the Islamic institutions to the different stakeholders and the environment.

The second duty for Islamic institutions is to contribute to wealth maximization in order to achieve well-being for various groups of stakeholders that have direct financial connections with them: shareholders, consumers, employees, suppliers and society at large. Hence, from this perspective, in contrast with Western business institutions that place profit as their primary objective, Islamic institutions must incorporate their obligations for social responsibility as much as for profit maximization (Ahmad, 2000).

Corporate social reporting is reflected within a framework of social relationships. Understanding corporate social reporting from an Islamic perspective is based on the concepts of accountability before *Allah*, the role of mankind as a vicegerent on earth (*Khalifah*), and justice and social responsibility.

2.4.1 Accountability

The concept of accountability from an Islamic perspective is influenced by the apparent relationships between individuals and business organizations with *Allah*. This reflects the meaning of the fundamental Islamic concept of *Tawheed* (the Oneness of *Allah*). *Tawheed* (Monotheism) is the Oneness of *Allah* as the highest principle of Islam (Choudhury & Hussain, 2005) which entails that because there is only One, *Allah* who is the Creator and the Owner, Islam necessitates an absolute submission to Him in all aspects of human life (Hameed, 2001; Maali *et al.,* 2006; Muwazir *et al*., 2006). In other words, the concept of the Oneness of *Allah* in the context of Islamic *Shariah* emphasizes the relationships of Muslims not only to *Allah*, but also with each other and to society.

Based on the concept of the Oneness of *Allah*, accountability to *Allah* in the broader meaning includes accountability to society and the environment (Muwazir *et al.,* 2006). Extending the concept of the Oneness of *Allah* to the situation of socio-economic, financial and political accountability creates relationships between the management of the business organizations and shareholders and other stakeholders. For that reason, all business organizations' transactions must comply with the *Shariah* rules and principles, and no activities will affect the welfare of the Islamic society (*Ummah*); accountability in this context reflects the accountability to *Allah* in a more general meaning.

2.4.2 Vicegerent (*Khalifah)*

The concept of *Khalifah* (vicegerency) refers to an individual's situation and its function, identifying the person's duties to himself and his duty to the *Ummah* (Islamic society) as a whole. Based on this concept, *Allah* is the ultimate owner of everything such as wealth and resources, and that mankind is not free, but responsible and accountable before *Allah* (Maali *et al.*, 2006; Muwazir *et al.*, 2006). Islam allows private ownership, but this ownership is not absolute. The humans, as vicegerents of *Allah* on Earth; are given the trusteeship over everything besides the right to use and pre-serve everything also for their wellbeing. This right to use comes with obligations and responsibilities. Since Islam grants humans the right to use, not the right to own, *Allah* puts restrictions and duties on the right to use that has been defined by Him. The *Ummah*, however, is given the responsibility of ensuring that individuals discharge their obligations and fulfil their obligations in utilization the resources. Islam grants individual rights the freedom as to use resources, ensures its proper using by imposing duties and responsibilities on this right, and entrusts the *Ummah* with the authority to enforce them.

Extending the concept of vicegerent (*Khalifah*) to Islamic business organizations means that managers are required to use their resources based on the principle of the Oneness of *Allah* (Muwazir *et al*., 2006). Accountability from an Islamic perspective requires that Islamic business organizations should employ those resources to generate a maximum added value for their benefit and the benefit of the Islamic community (*Ummah*) at large.

2.4.3 Justice and Social Responsibility

In Islam, justice and social responsibility refer to the concept of brotherhood (*Akhowa*) (Maali *et al*., 2006; Muwazir *et al*., 2006). *Allah* says in the Qur'an (49:10): "All Muslims are considered to be brothers". Muslims are supposed to be responsible for each other in a community, and the *Sunnah* explained this meaning: "the Muslims in their mercy towards each other are like a body, if a single part of it complains the other parts would be affected" (*Sahih Al-Bukhari*, Ali, 1961) and doing harm is not allowed. There are many examples of social justice practices that are emphasized by Islam such as prevention of usury (*riba*), the religious tax *Zakah*, and interest-free loans (*Quard Hassan*).

Allah describes justice in two words: *Adl* and *Qist*; *Adl* means equity, or balance. *Allah* has commanded the maintenance of justice under all circumstances and in all aspects of life (The Qur'an 6:152, 5:9). Muslims are encouraged to behave justly towards all. The Just is tied to an individual's very faith as a Muslim. *Allah* commands Muslims to be just and truthful in all aspects of life, and at all times, not only among them, but even when they deal with their enemies. *Adl* applies to the concept of balance and equilibrium, which implies doing things in a fair manner. Justice is described by another important word in the *Qur'an*: *Qist*, which means "share, portion, measure, allotment, or amount". In other words, justice as characterized by *Adl* and *Qist* implies preserving the balance between the body needs, mind and soul.

Derived from the concept of social justice, Islamic business organizations are forbidden from dealing with any action that contains any type of exploitation or leading to unfairness or damage to a society and the environment. Islamic business organizations also require dealing justly with their stakeholders which include employees, clients, and all groups of stakeholders within the community in which they operate.

2.5 FRAMEWORK FOR CLASSIFICATION OF CSR STUDIES

According to Belal and Momin (2009), the literature classified CSR into three categories: studies regarding the extent and CSR disclosure level and their determinants, studies related to managerial perceptions, and stakeholder perceptions' studies. This study will concentrate on the first category of empirical studies by focusing on the motivations for and determinants of CSR disclosure.

2.5.1 CSR Disclosure by Conventional Financial Institutions

Despite a corporate social responsibility (CSR) having been a topic of increasing concern in the business world, studies that focus on CSR practices by financial institutions are still scarce (Branco & Rodrigues, 2006; Coupland, 2006; Day & Woodward, 2009; Douglas *et al*., 2004; Hamid, 2004; Khan, Halabi, & Samy, 2009; Menassa, 2010; Scholtens, 2009). These studies also were mostly descriptive and quantitative, and the majority of these studies employed the content analysis approach to determine the extent and disclosure level of CSR.

Douglas *et al*. (2004) selected a sample of six Irish banks and four international financial institutions. The annual reports of all ten institutions from 1998 to 2001 were analyzed using content analysis. Over the period 1998 to 2001, all annual reports of the sampled Irish financial institutions included some information related to social disclosure. The sample of Irish banks indicated an overall improve in the social disclosure level between 1998 and 2000, with a small reduce in 2001. In contrast, the social disclosure level in the sample of international banks showed a very significant increase in 2001. This means that Irish financial institutions with regards the disclosure level of social responsibility followed their international counterparts in a good way. In the annual reports of the sample of Irish banks, corporate governance and human resources were the issues most disclosed over the four years, whereas community involvement was the issue disclosed the least. The primary categories for disclosed social responsibility in the annual reports of the sample of international banks were community involvement, human resources, and corporate governance. Besides, none of the Irish banks disclosed any environmental policy, which created an additional significant difference between the two samples. In addition, their results showed that the Irish banks disclosed more information about their social responsibilities on their web-sites than in the annual reports.

Branco and Rodrigues (2006) investigated the extent of social responsibility disclosure among Portuguese banks through their web-sites in 2004 compared to annual reports in 2003 by using content analysis. The results showed that, based on the Internet medium, only one bank disclosed information for all groups (environmental, human resources, products and consumers, and community involvement), and one bank also did not show any social information on its website. A majority of the banks (74 per cent) showed just one (47 per cent) or two (27 per cent) of the groups measured. In contrast, in annual reports, all banks disclosed social responsibility information; three banks disclosed information on all four themes considered, but the most (73 per cent) only presented one (33 per cent) or two (40 per cent) of the themes considered. The results of this study revealed that the environmental information and human resources were disclosed in the annual reports more than on the Internet, while the internet disclosed more on products and consumers and community involvement information, even though the variation is unimportant in the latter case. This study also found that environmental information and community involvement have a statistically significant positive correlation with social responsibility disclosure, although human resources and products/consumers showed insignificant, positive associations. Furthermore, the results of hypothesis testing revealed that the relationship between disclosure of social responsibility and number of branches are greater in the annual reports than on the Internet. Moreover, the results indicated that listed banks provide further information of social responsibility disclosure than unlisted ones. Legitimacy theory asserts that banks with a good reputation have more reasons to give the explanation for its existence to society by disclosing social responsibility information. Therefore, the findings state that legitimacy theory could be expected to explain the disclosure of social responsibility among Portuguese banks.

Coupland (2006) examined and analyzed web-based financial and corporate social reporting (CSR) five reports of banking groups, namely: Lloyds/TSB, the Royal Bank of Scotland, HSBC, Barclays and the Co-operative Bank, based on a discourse/textual analytic method. The results of this study suggested that there was more increased attention paid to issues that could effect on the society and environmental. These banks were concerned with the marginal information, rather than produce stand-alone reports that indicated the increasing significance of CSR considerations.

Scholtens's study (2009) provided a framework to measure the corporate social responsibility of a sample of 32 large international banks from 15 countries. The banks were divided into three regions: North America (six banks), the Asia-Pacific (four banks) and Europe (22 banks) for the year 2000 and 2005. To assess their performance, this study adopted international codes, putting in place a certified management system for internal environmental policies and availability of financial products that aim at sustainable development and with regards to their social conduct, such as external relations in terms of the community, employee and ethics codes. This study also used 29 indicators for banks' CSR. To assess the banks' performance using publicly-obtained information, this research primary collected information from their own reports, their websites, or information from international organizations and NGOs. The results showed that there were no important variations among the three regions. Nevertheless, the findings demonstrated important differences between country and the performance of an individual bank. On average, banks from the Netherlands, Germany, France, and the UK achieved the highest score of CSR while banks from Sweden, Italy, and Japan had the lowest scores. The results for the individual banks revealed that Dutch Rabobank has the maximum score. ABN Amro, Barclays, and HSBC are the runner-up banks. The poorest performance for the banks was the two Scandinavian banks. This study also found a positive and significant relationship between CSR score of a bank and its financial size and quality. Generally, the results indicated that CSR performance of a bank improved considerably between 2000 and 2005. Moreover, there were significant changes with respect to their relative position regarding the performance of CSR. This study showed that CSR was an increasingly important issue in the international banking sector.

A study by Day and Woodward (2009) determined the extent to which CSR disclosure in published annual reports (2005) of 27 organizations within the financial services sector (nine banks, nine building societies and nine insurance providers) complied with their sector guidelines using content analysis. The results showed that the disclosure level of social and environmental was unfortunately low in the financial services sector. Banks had the highest percentage of social and environmental disclosure followed by insurance providers. For implementing the Forge guidelines, the larger reporting firms in the banking and insurance markets would appear to have used a structured approach with high-quality information.

Khan, Halabi and Samy (2009) examined corporate social responsibility (CSR) reporting by banks in Bangladesh and the users' perceptions relating to CSR disclosure issues. The study collected data from the annual reports for the period 2004-2005 of 20 selected banking firms listed on the Stock Exchange of Dhaka and questionnaires were used to examine the level of users' perceptions concerning CSR reporting. The findings of this study indicated that the selected banking firms provided little information related to CSR in their annual reports on a voluntary basis. For users' perceptions, user groups would like to see more disclosure of CSR reporting.

One of the latest studies was conducted by Menassa (2010). The study investigated the extent and disclosure of social information quality among Lebanese commercial banks using content analysis. This research also determined the factors that may affect the types of disclosures. The data was collected from the annual reports of 24 banks for the year 2006. The findings showed that the highest disclosure themes were human resource and product and customers, while the poorest disclosure theme was the environment due to the banking sector having a lesser impact on the environment compared with other industries (Simpson and Kohers, 2002; Branco and Rodrigues, 2008). In addition, results indicated that corporate social disclosure has a strong positive association with bank size and profitability whereas no association was shown with bank age.

There are other studies that did not focus on the banks and finance firms, but they included them in their sample (see, for example, Clarke & Gibson-Sweet, 1999; Tsang, 1997; Zeghal & Ahmed, 1990). Zeghal and Ahmed (1990) selected the largest six Canadian banks and nine petroleum firms that expected to provide a large amount of social responsibility information through company annual reports, mass media advertisements and company brochures. The outcomes of this study found that human resources theme was the major disclosure theme for the banks' annual reports, while for advertisements, it was products, and the most important disclosure group for the brochures was community involvement.

Tsang (1997) conducted a longitudinal study in the Singapore environment by using annual reports from 1986 to 1995 for 33 locally-incorporated firms in the three sectors (banking, food and beverage, and hotel) listed on the Stock Exchange of Singapore. It was found that 16 of the 33 firms did not disclose any information of social responsibility during the whole period. Although this study found that the banks disclose less social information than the hotels, the banking sector had the maximum percentage of firms providing social responsibility information during the ten-year period. Furthermore, the study tested the association between the nature of ownership and CSR in the five banks. The government was the majority shareholder of the Development Bank of Singapore (DBS) among the five banks. This public pressure may had influenced the DBS's management to provide more information about social responsibility than other banks. The finding was somewhat unexpected – the bank, in fact, provided less information related to social activities compared with its counterparts.

Clarke and Gibson-Sweet (1999) conducted a study of voluntary reporting by the top 100 UK firms in terms of community involvement and environmental issues. This study found that all industries that had high visibility such as consumer firms, banks and utility companies disclosed some amount of community involvement in their annual reports. There are three essential factors that drive the disclosure by these industries in the local communities, namely: reputation, legitimacy and goodwill.

The above studies indicated that there were aspects of development in corporate social responsibility disclosure practices over the years. However, the levels of disclosure are still low, and researchers found variations in CSR disclosure and practice among banking industries between countries. In other words, the involvement of banks towards CSR disclosure is not consistent across countries (Khan *et al*., 2009).

In conclusion, the above studies have many limitations. First, they concentrated more on the extent and types of CSR disclosure rather than the factors that may influence such disclosure. Second, they divided the themes of CSR into four or five groups, corporate governance, human resources, environmental issues, products and consumers, and community involvement. Third, the sample size that they used was relatively small. Finally, none of these studies had investigated the impact of corporate governance mechanisms on CSR disclosure.

2.5.2 CSR Disclosure by Islamic Financial Institutions

Although there has been a rapid growth of Islamic banks in terms of numbers and size in Islamic and non-Islamic countries, few studies have investigated CSR disclosure in the context of Islamic financial institutions, especially Islamic banks (see, for example, Abdeldayem, 2009; Farook & Lanis, 2005; Haniffa & Hudaib, 2004, 2007; Maali *et al*., 2006; Abdul Rahman, Md. Hashim, & Abu Bakar, 2010; Bukair & Abdul Rahman, 2011, Zubairu, Sakariyau, & Dauda, 2011; Abul Hassan & Harahap, 2011).

Like most of the earlier previous CSR studies in both developed and developing countries, major CSR studies of Islamic banks (such as Harahap, 2003; Maali *et al.,* 2006; Haniffa and Hudaib, 2007; Abdeldayem, 2009; Zubairu *et al*., 2011; Abul Hassan and Harahap, 2011) were quantitative and descriptive in their nature.

Harahap (2003) conducted a longitudinal study of Islamic values in the annual report of Bank *Muamalat* Indonesia (BMI) over an eight-year period from 1993 to 2000 using comparative and analytical methods. These methods took two ways: first, comparison of the conventional accounting disclosure requirements with the AAOIFI standards; second, analysing the annual report of BMI and comparing those reports with those two standards. This study also used Bank Islam Malaysia Berhad (BIMB) and Faisal Finance Institution as part of a comparative study. The 1996 annual report of Bank Muamalat disclosed more information than the 1995 annual report. Furthermore, the information contents in the 1999, 1998, and 1997 annual reports were quite alike. The results of this study revealed that the primary contents of BMI annual report were more in complying with the items disclosed in the Susanto study list (1992) rather than with the standards issued by AAOIFI. This result was because that BMI must comply with regulations of the Indonesian Central Bank and the Indonesian Accounting Standards, or PSAK 38, for banking. This study showed that only one item (number 7) from a total of 29 items of the information specifically regarding Islamic values was disclosed. This means that 87.7% of the information disclosed in the annual report followed the conventional accounting standards. This study also showed that the contents of the BIMB annual report in 1996 did not disclose the Islamic values; it just disclosed the amount of *Zakah*. Other information such as asset restrictions, unlawful transactions and the sources of and uses of *Zakah* were not available. In addition, the 1998 annual report of Faisal Finance Institution Inc. provided less information related to Islamic values and no information was disclosed with regards the *Shariah* Supervisory Council Report.

Using content analysis techniques, Farook and Lanis (2005) analyzed CSR disclosure among 47 of the Islamic banks from 14 countries through their annual reports for the year ending 2002 or 2003 based on principles of Islam. They examined the factors influencing corporate social responsibility disclosure of Islamic banks based on legitimacy and political economy perspectives. These determinants were corporate governance variables, which included the *Shariah* supervisory board and investment account holders' rights. They found that the mean value of disclosure of CSR for all 47 Islamic banks in the sample was around 16.8%, and the maximum mean of information disclosure was 48.3% of expected disclosure. Several of the Islamic banks did not disclose any CSR information. The study showed that most of the

Islamic banks in the sample disclosed very little CSR information with clear differences in the levels of disclosure. This study also found that the control variable SIZE (log total assets) was not significant related to CSR disclosure which inconsistent with previous researches. The reason for this result is because the study was cross-national and log of total assets was an inappropriate measure that did not consider the variations in size between countries. Furthermore, the results of hypothesis testing showed that the political rights and civil liberties' variables were not statistically significantly with CSR disclosure. However, the variable for the proportion of Muslim population was significant regarding the disclosure level of CSR. The investment account holders' rights variable was significant at the 10% level. In addition, this study found that the *Shariah* supervisory board (SSB) and its characteristics was the critical factor in affecting disclosure of CSR and was highly significant. The results of this study suggested that the relevant public and controlling corporate governance mechanisms, such as SSB, raise the CSR disclosure level among Islamic banks.

Maali *et al.* (2006) also investigated the CSR disclosure level in the 29 annual reports of Islamic banks from 16 countries (Jordan, Sudan, Iran, Bahrain, UAE, Palestine, Egypt, Turkey, Pakistan, Kuwait, Bangladesh, Qatar, Albania, South Africa, Russia and Mauritania) for the year ending 2000 through a pragmatic benchmark based on the principles of *Shariah* using content analysis. They found the mean value of corporate social disclosure for all banks in the sample was 13.3%. They found also that the disclosure level of Islamic banks was not associated with their benchmark. Because many of the expected items were required by AAOIFI standards, only 11 (38%) of the banks followed their requirements and 18 (62%) of these banks did not apply them. In addition, they found many banks that claimed to have adopted AAOIFI standards, generally, tended to evade any mentioning about the nature and the amount of unlawful (*haram*) dealings, and the banks in Sudan tended to not provide disclosure about *Zakah*, which claimed to implement AAOIFI requirements based on laws by the Sudanese Central Bank. Maali *et al.* (2006) found that the banks operating in not totally-Islamized economies disclosed more social information than the banks operating in completely Islamized economies. This is because the banks in non-Islamized economies working side by side with conventional banks that needed to provide additional information to the community about social issues based on Islamic principles, whereas banks working in completely Islamized economies do not have any information to disclose. Regarding the content analysis by categories, this study showed that no one of the banks provided any information regarding the environment and there was no disclosure regarding the treatment of insolvent clients. Only the banks following AAOIFI standards disclosed the nature and amount of revenue from unlawful dealings. Two of Islamic banks provided detailed information about *Quard Hassan*. Eighteen of the banks provided information regarding employees. In addition, this study found that the report of the *Shariah* supervisory board was the item most disclosed by the majority of Islamic banks where only twenty-one of the banks (72%) offered this report.

Haniffa and Hudaib (2007) explored the communication practices of seven Islamic banks (Abu Dhabi Islamic Bank, Al-Baraka Bank, Al-Rajhi Bank, Bahrain Islamic Bank, Dubai Islamic Bank, Kuwait Finance House and Shamil Islamic Bank) in four countries in the Arabic Gulf region, namely: Bahrain, Saudi Arabia, Kuwait and the United Arab Emirates. The data collected from the annual reports of those banks during the period from 2002 to 2004 was published in an English version on the Internet by using content analysis. The results showed that the overall Ethical Identity Index (EII) for all three successive years went to the Islamic Bank of Bahrain, followed by Shamil Islamic Bank, whereas the least was Al-Rajhi Bank. This means that Bahrain Islamic Bank had the lowest incongruence between the ideal and the communicated ethical identities although Al-Rajhi Bank had the largest incongruence. This study also showed that the index of each bank through the period of three years suggested that communication was not static and usually the least. Furthermore, this study found that the largest discrepancy between the ideal and communicated ethical identities was categorized under four dimensions, consisting of commitments to society, their vision and mission, contribution and management of *Zakah*, charity and benevolent loans and information related to top management.

In line with the above CSR disclosure studies by Islamic banks, a study by Abdeldayem (2009) investigated CSR disclosure among the seven Islamic banks of United Arab Emirates (UAE). The annual reports of six of these banks (Dubai Islamic bank, Abu Dhabi Islamic bank, Sharjah Islamic bank, Emirates Islamic bank, Dubai bank, and HSBC Amanah Islamic bank) were analyzed by using content analysis and Al-Noor bank was excluded from the analysis. The results indicated that two of six Islamic banks (33.3%) claimed to follow AAOIFI requirements. The results also showed that only one bank in UAE disclosed information concerning the environment category while there was no information disclosed about the treatment of late repayment and insolvent client themes. Two of the banks that were following AAOIFI standards (Dubai Islamic Bank and Sharjah Islamic Bank) disclosed information about the amount and nature of unlawful activities. In addition, four banks (67%)

disclosed information about employees in that bank, as well as provided the *Shariah* supervisory board report. Therefore, in general, the results suggested that corporate social disclosure was not the major concern in annual reports for the majority of Islamic banks in UAE.

In a longitudinal study, Abdul Rahman *et al.* (2010) investigated the themes, locations, extent, as well as trends of corporate social responsibility (CSR) disclosure by Bank Islam Malaysia Berhad (BIMB) during the period from 1992 to 2005. A content analysis approach was employed to assess corporate social responsibility. The number of sentences was employed as a basis of measurement.

They developed a CSR disclosure index consisting of nine themes. These themes are unusual supervisory restrictions, unlawful transactions, Zakat obligation, *Qard* fund, community involvement, employees, environment, product/service contribution and *Shariah* Supervisory Council. The findings of the study showed that Bank Islam Malaysia Berhad does not provide any form of information related to the themes of unusual supervisory restrictions, unlawful transactions, and environment. The findings from this study also indicated that the highest disclosure theme is *Shariah* Supervisory Council (47%), followed by employees (39.45%), product and service contribution (34.25%), and community involvement (12.49%). Moreover, the most common locations in disclosing information regarding CSR are the statement of the chairman, financial statements and the report of directors. Overall, from the results of corporate social responsibility disclosure, the bank improved the amount and way of providing information in its annual reports from year to year.

In the Gulf region, Bukair and Abdul Rahman (2011) investigated the influence of *Shariah* supervisory board (SSB) structure on the disclosure level of corporate social responsibility (CSR) in 38 annual reports of Islamic banks for the year 2008. The attributes of SSB included the existence of SSB, the size of SSB, the cross-memberships of SSB, the qualifications of SSB members and reputable scholars on SSB. This study used content analysis to measure the extent of CSR disclosure through the number of sentences. Overall, the findings of the descriptive statistical analysis revealed there is an increase in publishing CSR information in the annual reports compared with previous studies (Farook and Lanis, 2005; Maali *et al*., 2006). All banks in the sample disclosed some form of information related to CSR. The highest disclosure theme found in this study is top management followed by the themes of product and service and employees, respectively. This study also found that the Quard Hassan and environment themes displayed the lowest disclosure. The results of ordinary least square regression indicated that the combination of SSB characteristics has the highly positive significant effect on the disclosure level of CSR in the annual reports of Islamic banks.

Recently, Zubairu *et al.* (2011) studied the social reporting of Islamic banks in Saudi Arabia based on the Ethical Identity Index (EII) developed by Haniffa and Hudaib (2007) by using ten dimensions. The data was collected from the annual reports of four fully-fledged Islamic banks on the Internet for the year 2008-2009. These banks are Al Rajhi Banking and Investment Corporation, National Commercial Bank, Saudi Hollandi Bank and Riyad Bank. The findings showed that Islamic banks in Saudi Arabia practiced less social disclosure in their annul reports in contrast with the expectations that they operate in line with the principles of the *Shariah*. The study found that the more important dimension of the ten dimensions was the banks' commitment to debtors, which achieved a higher disclosure compared with the others. On the other hand, the worst disclosure dimension was the banks' activities regarding the environment. Without a doubt, the greatest in conformity between disclosures of both actual and ideal levels is referred to in five dimensions, arranged from the poorest to the highest: 1) Environment; 2) *Zakah*, charity and benevolent loans; 3) Products and services; 4) Commitment to community; 5) Vision and mission statements. The reason behind these results is that Islamic banks in Saudi Arabia have more dealings with their conventional counterparts than banks that are supposed to act according to the *Shariah*. This is because they provide more information related to debtors and corporate governance than other dimensions that affect the well-being of society.

Consistent with the study by Zubairu *et al.* (2011), Abul Hassan and Harahap (2011) explored the actual disclosure of corporate social responsibility (CSR) information compared with the CSR disclosure index that has been developed and derived from the framework of Islamic business ethics. They collected data from the annual reports of seven Islamic banks from different countries for the year 2006 to measure the disclosure level of CSR using content analysis technique. These banks are Al-Shamil Bank (Bahrain), Al-Rajhi Bank (Saudi Arabia), Islami Bank Bangladesh (Bangladesh), Bank Islam Malaysia (Malaysia), Dubai Islamic Bank (United Arab Emirates), Bank Muamalat Indonesia (Indonesia), and Kuwait Finance House (Kuwait). The study classified CSR into six categories, eight dimensions, and 78 items. The study ranked the results of CSR dimensions from the highest to the lowest disclosure as follows: 1) Community related to strategic social development; 2)

Shariah supervisory board 3) Products and services; 4) Employee; 5) Corporate governance, as well as research and development; 7) Ethics behavior; 8) The environment. The findings showed that the greatest incongruence between actual social disclosure and disclosure index in the annual reports was due to four dimensions including community, ethics behavior, research and development and corporate governance.

What is essential in these studies involving Islamic banks is the type of CSR and sampling size collected for analysis as well as the methodology they used. All these studies used a descriptive approach to analyze Islamic values and CSR based on small samples of the banks, except the study by Farook & Lanis (2005), who employ a more extensive study of CSR disclosure. This is because the study examined Islamic corporate governance mechanisms and socio-political variables that influence CSR disclosure through the annual reports of 47 banks from different countries.

The above studies suffer from a number of deficiencies. Firstly, all those studies, (except for Farook and Lanis), concentrated on the nature and extent of Islamic values and CSR disclosure rather than the determinants that may affect such disclosure. Secondly, they only considered a limited range of Islamic values and CSR disclosure. Thirdly, they only used a small sample of financial institutions. Lastly, most of those studies used zero or one score to measure the volume of social disclosure.

The present study differs from previous studies generally in many ways. The study uses a large sample of banks to resolve the rudimentary analysis in those studies. Furthermore, this study also examines the determinants of CSR disclosure, not just the

Islamic corporate governance mechanisms. In addition, it employs a more extensive scoring sheet, consisting of 75 items, and develops the categories of CSR classification by adding a new theme; poverty. The study used the number of sentences as a base to measure the volume of CSR information. Such an approach allows generalizations to be made relating to the extent of CSR disclosure in the Islamic banks' annual reports.

The present study also differs from the study of Farook and Lanis (2005) in many ways: first, it examines the influence of all independent variables on CSR disclosure separately. Second, it tests other governance mechanisms in depth, not just the *Shariah* board, such as the effectiveness of the board of directors and audit quality. Third, it measures the overall corporate governance score. Fourth, the number of sentences has been used to examine the existence of CSR information in the annual reports. Fifth, it employs two firm characteristics: bank size and financial performance as control variables. Finally, it uses a large sample of Islamic banks operating around the world.

2.5.3 Corporate Governance and Corporate Social Responsibility (CSR)

Based on the results of the study conducted by Bushman, Piotroski, and Smith (2004), there were two groups of factors that can affect the levels of corporate disclosure and transparency within a firm. The first group consists of corporate governance variables while the second group consists of specific firm characteristics. This study concentrates on the first group of factors that may affect the disclosure type and level of CSR that could contribute to the development of a CSR theory.

The collapse of Enron, WorldCom, HIH Insurance and Ihlas Finance House (IFH) of Turkey in 2001 reinforced global awareness of the need for the presence of corporate governance based on stakeholders' accountability and financial transparency. Increasingly, consumers, investors, employees, creditors, legislators and regulators have become aware of the firms' social performance (Gray *et al.*, 2001).

Results of the previous researches regarding determinants of the voluntary disclosure level were inconclusive. There have been numerous empirical studies that sought to examine the relationship between corporate governance variables of a firm and the level of voluntary disclosure in both financial and non-financial companies among various countries (Akhtaruddin, Hossain, Hossain, & Yao, 2009; Barako & Brown, 2008; Barako, Hancock, & Izan, 2006; Eng & Make, 2003; Ho & Wong, 2001; Huafang & Jianguo, 2007; Gul & Leung, 2004; O'Sullivan, Percy, & Stewart, 2008).

Akhtaruddin *et al.* (2009) investigated empirically the association between many corporate governance attributes and the level of voluntary disclosure in the annual reports of companies listed on the Main Board of the Bursa Malaysia at the end of 2002. They applied un-weighted disclosure indices to the 105 annual reports. They examined the relationship between the extent of voluntary disclosure and various corporate governance characteristics by using the ordinary least square regression model. The governance factors are size of the board, percentage of independent non-executive directors (INDs) on the board, outside share ownership, family control, and ratio of audit committee members to total members on the board. Results showed that a positive relationship exists between board size and percentage of INDs and the level of voluntary disclosure information in the annual reports while the extent of voluntary disclosure was negatively regarding family control. However, the percentage of audit committee members to total members on the board was not associated with voluntary disclosures.

O'Sullivan *et al*. (2008) explored the function of corporate governance in the decision-making to voluntary disclosure forward-looking information in Australian companies. The data were collected from 2000 and 2002 published the annual reports of the largest 200 publicly listed companies based on net profit for the year 2000 and 183 firms for 2002, as identified in the Business Review Weekly. The results showed that the mean value of the overall governance score for 2000 and 2002 were 2.28 and 2.70, respectively. The analysis indicated that the number of companies with the highest score of corporate governance increased from only one company in 2000 to 12 companies in 2002. Eight of these companies disclosed forward-looking information in their annual reports. The results pointed out that the mean value of OSHIP; BOARD; AND AUDIT grew from 2000 to 2002 and showing improvement in the overall corporate governance. In addition, the mean value of the individual governance attributes also increased from 2000 to 2002. The results of logistic regression for the year 2000 showed that audit quality, the existence and the quality of board committees were positively significant at ($p = 0.022$) and ($p = 0.077$), respectively, and correlated with the forward-looking information disclosure in the annual reports. However, the results found no relationship between board autonomy and independent ownership and the level of forward-looking information voluntary disclosure in the annual reports. For controlling variables, the results found that only information environment was positively significant at ($p = 0.084$) and correlated with the voluntary disclosure of forward-looking information. In the second regression model, the results showed that the overall corporate governance was positively and significantly related to the forward-looking information voluntary disclosure in the annual reports. Two of the control variables, firm size and information environment, were positively significant at $p = 0.045$ and $p = 0.063$, respectively, and associated with the forward-looking information voluntary disclosure in the annual reports. In the year 2002, the results showed that just one of the independent variables, audit quality, was positively and insignificantly associated with the voluntary disclosure of forward-looking information in the annual reports, while there was no significant relationship between the board autonomy, presence and quality of board committees, independent ownership and the system of overall corporate governance and the forward-looking information voluntary disclosure in the annual reports. Only leverage was positively and significantly associated with the forward-looking information voluntary disclosure in the annual reports.

Huafang and Jianguo (2007) examined the impact of ownership structure and board composition on voluntary disclosure in the annual reports of 559 Chinese firms listed on the Shanghai Stock Exchange in 2002 from 11 non-financial industry sectors. Disclosure scores were computed from thirty items of required information in a firm's annual reports based on the literature. They classified these items into four categories, consisting of information related to background information, information regarding business, financial information and non-financial information. The results of the study indicated that the managerial ownership, state ownership and legal-person ownership were insignificant associated with the level of voluntary disclosure while both block-holder ownership and foreign listing/shares ownership were positive and significantly associated with the level of disclosure. This study also found that the percentage of

INDs on the board to be positively and significantly correlated with the disclosure level while CEO duality was negatively significant related to the voluntary disclosure. It was suggested that an increase in independent directors would increase disclosure and voluntary disclosure decreased with CEO duality. In addition, the results showed that larger firms had greater disclosure than small ones and firms that had the higher proportion of intangible assets tended to disclose more information than others. Nevertheless, the findings found no significant association between voluntary disclosure and audit reputation, and found that the leverage ratio was not correlated with voluntary disclosure.

Barako *et al*. (2006) extended the prior literature by providing a longitudinal examination of the voluntary disclosure practices in a developing country, Kenya, for the period of study from 1992-2001. They investigated the association of corporate governance characteristics and firm attributes with voluntary disclosures of selected information in the annual reports of 54 Kenyan firms listed on the Nairobi Stock Exchange market fact file – 2002. This study classified the companies into four major industries: agriculture; commercial and services; finance and investments; and industrial and allied. The results showed that there was an increase in the level of voluntary disclosure by Kenyan firms through the period of the study. For example, in 1992, 27 firms scored less than 10% on the disclosure index, while by 2001; one firm in the finance and investments' industry scored at least 50% of the items in the disclosure index. For the sample characteristics, the number of firms that had an audit committee, for instance, increased from nine firms (21%) in 1992 to 23 firms (52%) by 2001. The results revealed that the presence of an audit committee was positively significant and a strong determinant correlated with the voluntary disclosure level and the percentage of non-executive directors on the board was found to be significantly and negatively correlated with the level of disclosure. In contrast, the structure of board leadership did not seem to have a significant effect on the voluntary disclosure level by firms. The results also showed the negative, significant association between shareholder concentration and voluntary disclosure, while the percentage of foreign ownership and ratio of institutional ownership were found to be positively and significantly correlated with the disclosure level. In addition, company size and leverage were found to be positive and significantly correlated with the level of disclosure while the audit firm variable was found to not be significant.

Gul and Leung (2004) examined the relationship between the structure of board leadership, consisting of CEO duality and the ratio of expert outside directors on the board and voluntary disclosure from the annual reports of 385 Hong Kong firms in 1996, using regression analysis. The results of this study showed that CEO duality was significantly, negatively correlated with the level of disclosures, supporting the view that the role of chairman and CEO should not be in the one hand of a person. The findings also showed that companies with a higher ratio of the expertise of non-executive directors were negative and significantly correlated with the extent of disclosure. This result suggested that an increase in the outside directors decrease voluntary disclosure among Hong Kong companies. Both results suggested that increased monitoring by the independent and outside directors were associated with a lower disclosure level. In addition, results revealed that larger firms, firms with a higher ROE, companies with greater growth opportunities and poor performing companies voluntarily disclosed more information in their annual reports.

Eng and Make (2003) examined the influence of ownership structure and composition of the board on voluntary disclosure. Ownership structure was measured by managerial ownership, block-holder ownership and government ownership. The composition of the board was measured by the proportion of independent directors. The sample for this study was selected from annual reports of 158 companies listed on the Stock Exchange of Singapore for the year 1995 from all nine different industry sectors. The results showed that ownership structure and the board's composition influence disclosure. This study found a negative and significant relationship between managerial ownership and the disclosure level, while government ownership was positively and significantly associated with the disclosure levels, whereas block-holder ownership was not significantly related to the level of voluntary disclosure. The results found that the ratio of outside directors on the board was negatively correlated with disclosure. It also found that larger companies and companies with lower debt had higher disclosure. These results suggested that outside directors on the board of Singaporean firms play a substitute-monitoring function to voluntary disclosure.

For control variables, results showed a positive, significant relationship between the level of voluntary disclosure and firm size while found the negative and significant relationship with leverage. Nevertheless, the results showed no significant association between the extent of disclosure and growth opportunities, industry type, auditor reputation, analyst following, stock price performance and profitability.

Ho and Wong (2001) investigated four major corporate governance factors (the percentage of independent directors to the whole members of directors on the board, the existence of a voluntary audit committee, the existence of dominant personalities (CEO/Chairman duality) and the ratio of total family members on the board) with the disclosure level provided by listed companies in Hong Kong in late 1997 and early 1998, using a questionnaire survey. The results showed that the existence of an audit committee and firm size were significantly and positively correlated with the level of disclosure, while the proportion of family members on the board was negatively and significantly correlated with the voluntary disclosure level. However, the results showed that the existence of a dominant personality has a negative and insignificant correlated with the level of voluntary disclosure while the association between the percentage of independent non-executive directors on the board and the voluntary disclosure level was positive, but not significant. This study also found no significant association between the level of disclosure and the remaining variables (family ownership control, profitability, asset in place and leverage).

Few empirical studies have investigated the relationship between corporate governance attributes and the social and environmental disclosure, such as Buniamin, Alrazi, Johari and Abd Rahman (2008), Abdur Rouf (2011), Halme and Huse (1997), Haniffa and Cooke (2005), Khan (2010), Li *et al*. (2008), Rashid and Lodh (2008) and Said, Zainuddin and Haron (2009). The majority of these studies used content analysis methods.

Halme and Huse (1997) examined the relationship between environmental reporting and the corporate governance variables (ownership structure and board of directors), industry variables and country variables by using content analysis. A sample was selected from ARs in 1992 for the 40 annual reports of the largest companies in four industrialized Western countries, Finland, Norway, Spain and Sweden. The findings of this study indicate that the industry variable has to be the most important factor influencing environmental disclosure in the annual reports. The results also indicated that the impact of the extent of environmental information is positively correlated with environmental reporting.

Although the relationship between the number of board members and corporate environmental disclosure was positive for ARs in some cases of the analyses, there were significant variations in the number of board members among the four countries. The overall findings from the study did not show any significant association with ownership concentration or the number of board of directors' members.

Halme and Huse (1997) found that the Norwegian companies likely showed more environmental disclosure in their annual reports than corporations in the other countries. The Finnish firms paid less attention to the environmental issues than Norwegian and Swedish firms.

Although the study found no significant relationship between firm size and disclosure, it shows that the largest companies tended to provide some information related to environmental issues, but not more than small firms. Therefore, the results suggested that both industrial affiliation and concentration of the country might explain some of the differences in the disclosure level.

Haniffa and Cooke (2005) examined the association between corporate social disclosure (CSD) and three groups of factors: culture, corporate governance and firm-specific (control) characteristics in the annual reports of 139 non-financial Malaysian firms listed on the Main Board of the KLSE in two different time periods, 1996 and 2002, using legitimacy theory as the theoretical framework. This study found that the level of CSD had a significant relationship with the boards dominated by Malay directors; the boards dominated by executive directors; chair with multiple directorships and foreign share ownership while the proportion of Malay shareholders had a positive, significant relationship with the level of CSD in 2002. However, the impact of ethnicity of finance directors was insignificantly associated with CSD. The results also showed that the independence of non-executive directors was negatively significant associated with corporate social disclosure. Four of the control variables (size, profitability, multiple listing and industry type) were significantly correlated with CSD, except for gearing. The results also found that the type of industry had a less significant influence on the CSD.

Zeghal, Mouelhi and Louati (2007) investigated the relationship between the extent of research and development (R & D) voluntary disclosure and three categories of factors, namely, specific-firm characteristics (size, leverage, listing status), research and development (R & D), related variables (R & D intensity, R & D partnership agreement, R and D accounting policy) and corporate governance attributes (board independence and separation of the CEO and board chair roles) by the annual reports of 150 Canadian companies listed on the Toronto Stock Exchange (TSX) for the year 2003 or 2004. The findings reveal that company size, R & D intensity, R & D partnership agreement, and the separation of the CEO and board chair functions have a significant positive influence on the extent of R & D disclosure, while the other variables show an insignificant association with the disclosure level of R & D.

A study conducted by Li *et al*. (2008) provided a comprehensive review of the literature on the intellectual capital disclosure (ICD) of firms based on the previous theoretical perspectives which included legitimacy and stakeholders, signalling, media agenda setting, agency and information asymmetry. They investigated the relationship between the level of ICD and corporate governance factors, controlling for other firm-specific attributes, for a sample of the 100 annual reports of UK listed firms on the London Stock Exchange for financial year-ends between March 2004 and February 2005. The independent variables comprised different forms of the corporate governance mechanisms: composition of the board of directors, structure of the ownership, size of an audit committee, audit committee meetings' frequency and the role duality of CEO. Results of this study revealed that board composition had a positive significant correlated with all three measures of the ICD. This means that a company that had a higher number of independent non-executive directors on the board had the higher ICD. This result suggested that board composition was one of the most important corporate governance factors for ICD, and supported the arguments of both agency and resource independence theories. In contrast, the results found that role duality was not associated with the ICD. The results also showed that there was a negative significant relationship between share ownership concentration and ICD. The results suggested that firms with high concentrated share ownership were less responsive to investors' information costs, because the major shareholders had regular access to the information that they require, such as intellectual capital information. In addition, the results showed that size of an audit committee had a significant, positive association with two measures of the intellectual capital disclosure (ICDI and ICWC). The findings indicated that firms with larger audit committees tended to provide additional information for intellectual capital in their annual reports. The association between frequency of audit committee meetings and the level of ICD was positive and significant. This result suggested that activity of an audit committee is an important determinant in monitoring the behaviour of management and decreasing information asymmetry by the disclosure level of intellectual capital.

For the controlling variables, the results showed that there was a positive, significant association between company size and the ICD level. The association between the ROA and one measure of the ICD measures (ICDI) was positive and significant while listing age was negative and significant related to the extent of ICD. In general, the findings showed that all corporate governance mechanisms together with company size, profitability and listing age were correlated with one or more of the disclosure measures of intellectual capital.

Rashid and Lodh (2008) investigated whether ownership concentration and the imposition of regulation on the corporate governance practices, in terms of a change of board composition, influence the practices of voluntary social disclosure in Bangladesh. The sample was selected from the listed firms on the Dhaka Stock Exchange for the period 2005 and 2006. This research selected 21 firms from a variety of industries based on a company’s highest market capitalization and compliance with the Corporate Governance Notification 2006. The results showed a positive, significant association between the board composition and debt and the extent of social disclosure. The results found no significant relationship between the disclosure level of social information and ownership concentration by directors after the imposition of the corporate governance notification, while a negative significant association was with director share ownership. The results also found that other variables were not correlated with the disclosure level. They suggested that the imposition of regulation on corporate governance practices could significantly affect the social disclosure level in developing countries such as Bangladesh.

A further study by Barako and Brown (2008) examined the impact of gender and board representation on the level of corporate social disclosure by 40 Kenyan banks through their annual reports, using an un-weighted disclosure index. Results indicated that although most of Kenyan banks had no women on their boards (about 75% of the sample population), only two banks (5%) had at least three women on the board of directors. Barako and Brown (2008) found no banks disclosed information regarding recruitments, employment of special groups, assistance of retiring employees, employees' productivity and turnover. They also found 5 (12.5%) of the banks provided information about environment policy in their annual reports, while just 0.03% of the banks disclosed information relating to environmental activities. In addition, only three banks shared in the campaign of national AIDS. However, in general, results showed that the level of social disclosure by Kenyan banks was low, with a mean of 15%, showing that corporate governance disclosure did not have the highest attention for Kenyan banks. The findings of the multiple regression model indicated that representation by women and independent directors had a positive, significant relationship to the disclosure level. The findings also found that both the percentage of foreign nationals on the board and non-performing loan ratio (the control variable) were not significantly related to the disclosure level of social information.

A study by Buniamin *et al.* (2008) investigated environmental reporting in the corporate annual reports of 243 firms listed on the Main Board of Bursa Malaysia for the period 2005. The study also examined the relationship between the independence of board of directors, CEO duality, management ownership and size of the board and information related to the environment. The study used content analysis to measure environmental disclosure in the annual reports of those listed firms. Descriptive statistical analysis indicated that only 68 firms (28%) of the whole sample provided some form of information regarding the environment in their annual reports for the period of study. Concerning the sectors, the greatest amount of information was disclosed by industrial products (28%), trading/services (26%), properties (15%) and plantations (13%). Therefore, regarding the industry basis, the plantation sector has the highest amount of information related to environmental issues provided (64%) compared with the other industrial sectors. The results from the logistic regression showed that only board size among all corporate governance factors had a positive significant association with environmental reporting. The findings of the control variables also indicated that both the environmental sensitivity and firm size have significant, positive associations with disclosure information related to the environment in the annual reports.

Said *et al*. (2009) conducted a study on Malaysian public-listed firms for the year 2006 to measure the association between corporate governance variables, consisting of size of the board of directors, independence of the board, role duality, audit committee, ten largest shareholders, managerial ownership, foreign ownership and government ownership and the disclosure of CSR. They extended prior research on the development of the CSR index by using firms' websites. The data were collected from 150 non-financial companies' annual reports and websites in the Main Board of Bursa Malaysia from ten different sectors. Results showed that the disclosure level of corporate social responsibility by Malaysian companies were generally low, with a mean of 13.9%. Results also found that product themes had the highest amount of disclosure in both annual reports and websites of firms, followed by the theme of human-resource and environment, respectively. Results of testing the hypotheses showed that just three variables (government ownership, ownership concentration, and audit committee) were positively and significantly related to the CSR disclosure. Government ownership has the major significant influence on the corporate social responsibility disclosure level. This suggested that the government may increase pressure on firms to disclose more information for the public. The results for the controlling variables showed that company size had a positive, significant association with CSR disclosure while profitability had a positive but insignificant association.

Al-Arusi, Selamat and Hanefah (2009) examined the association between the level of voluntary financial and environmental disclosure on the Internet and some company characteristics and corporate governance variables by the annual reports of 201 Malaysian public-listed firms on the Bursa Malaysia Main and Second Boards for the 2005 financial year. The variables studied were chief executive officer (CEO) ethnicity, leverage, technology level, the existence of dominant personalities, profitability and company size. The results showed that the level of technology and ethnicity of CEO and company size influenced both financial and environmental disclosures on the Internet. However, the findings revealed that the existence of a dominant personality had a negative association with the extent of financial disclosure, but not with the environmental disclosure. The remaining factors did not reveal any significant relationships with disclosure level of financial and environmental information.

Another study by Khan (2010) focused on the disclosure of corporate social responsibility (CSR) by Bangladeshi listed commercial banks and the possible influences of corporate governance (CG) determinants, consisting of non-executive directors, the presence of foreign nationalities, and the presence of women in the board on the CSR disclosure. He adopted legitimacy theory as the theoretical framework to explain CSR practices by Bangladeshi banks and determinants that may affect the disclosure. He collected data from the annual reports of 30 private commercial banks listed on the Dhaka Stock Exchange for the years 2007-2008. Using content analysis, he found that although CSR reporting was voluntary in Bangladesh, the banks disclosed more than average CSR information in their annual reports. All private commercial banks disclosed more than 80 percent of the information for the products and services category. The results also showed that two corporate governance (non-executive directors and the existence of foreign nationalities) variables had a significant influence on CSR reporting in Bangladesh, while no significant association was found between women represented on the board and CSR reporting. With regards the explanatory variables, the study found that size and profitability had a significant relationship with CSR reporting by banks, but for the gearing variable, it was not significant.

One of the recent studies about corporate social responsibility disclosure (CSRD) was conducted by Abdur Rouf (2011). He explored the amount and level of corporate social responsibility disclosure in corporate annual reports of listed firms from different sectors on the Dhaka Stock Exchange (DSE) in Bangladesh. The study also examined the association between the characteristics of the firm and company-specific elements and CSRD using an ordinary least squares (OLS) regression. The data of corporate social responsibility was collected from the annual reports of these listed firms for the year 2008. The study employed an un-weighted approach to measure the volume of CSRD based on the disclosure index, including 39 items of information. The results showed that companies in the sample disclosed moderate information regarding disclosure level of corporate social responsibility. The findings of the ordinary least square regression revealed that the percentage of independent directors on the board of directors was positively significant with the disclosure level of corporate social responsibility. The results also revealed that company size did not influence the disclosure level of corporate social responsibility. Furthermore, the findings for the explanatory variables indicated that board leadership structure (BLS), board audit committee (BAC) and percentage return on equity (PROE) had significant, positive relationships with corporate social responsibility disclosure.

Furthermore, there have been very little empirical studies done on the association between the corporate governance mechanisms and corporate social responsibility (CSR) disclosure from an Islamic perspective. Farook and Lanis (2005) investigated the disclosure level of CSR in the 47 annual reports of Islamic banks for the year 2002 or 2003 from 14 countries using a benchmark based on Islamic principles through legitimacy and political and economic perspectives. The study also tested the association between corporate governance factors and disclosure of CSR. The results revealed that the extent of political and civil repression influenced the CSR disclosure level by the banks, and the most significant driver for CSR disclosure was pressure from the “relevant public”, being the Islamic society. The relationship between corporate governance variables and CSR disclosure were positive and highly significant, which leads to support the view that Islamic banks are also based on economic incentives. The most significant variable of corporate governance drivers for CSR disclosure was the SSB and its characteristics. In addition, this study found limited evidence on the extent of political rights and civil liberties and little support for investment account holders (IAHs) where any increase in IAHs leads to an increase in the level of CSR disclosure by Islamic banks. Surprisingly, the findings showed that the control variable ‘firm size’ was not statistically significantly associated with CSR disclosure. In general, results suggested that the relevant public and the presence of SSB generate pressure on the Islamic banks to improve the level of CSR disclosure.

Table 2.1
Summary of Previous Studies Examining Corporate Governance Mechanisms and Corporate Disclosures

Year of study	Author	Sample of Co. No. of Co.	Sample of Co. Type of Co.	Dependent variable	Independent variable	Significant variable	Country
1992	Halme and Huse (1997)	40	Non-classification	Corporate environmental disclosure	Ownership structure, industry variables and country variables	Industry variables	Finland, Norway, Spain and Sweden
1997, 1998	Ho and Wong (2001)	86 12 98	Non-financial Financial Total	Voluntary disclosure	Board composition, the existence of a voluntary audit committee, the existence of dominant personalities (CEO/Chairman duality), and the percentage of family members on the board	The existence of an audit committee	Hong Kong
1995	Eng and Make (2003)	133 25 158	Non-financial Financial Total	Voluntary disclosure	Managerial ownership, blockholder ownership and government ownership, and board composition, growth opportunities, size, debt, industry, auditor reputation, analyst following, stock price performance and profitability	Size and leverage	Singapore
1996	Gul and Leung (2004)	382 3 385	Non-financial Financial Total	Voluntary corporate disclosure	CEO duality, the proportion of expert outside directors on the board (PENED) , proportion of non-executive director on the board (PNED), size, shares held by director, director's ownership, debt, current ratio, return on equity (ROE), big 5, audit committee, market to book value (MB), equity market liquidity, firms listing, equity issues and firm's loss	CEO duality, PENED, size, ROE, MB and Firm's loss	Singapore

Table 2.1 (Continued)

Year of study	Author	Sample of Co. No. of Co.	Type of Co.	Dependent variable	Independent variable	Significant variable	Country
1996, 2002	Haniffa and Cooke (2005)	139	Non-financial	Corporate social disclosure	Malay dominated board, boards dominated by executive directors, chair with multiple directorships, foreign share ownership, size, profitability, multiple listing, type of industry and gearing	Malay dominated board, boards dominated by executive directors, chair with multiple directorships, foreign share ownership, size, profitability, multiple listing, type of industry	Malaysia
2002 or 2003	Farook and Lanis (2005)	47	Islamic banks	Corporate social responsibility disclosure	Political and civil repression, relevant public, SSB and IAHs	Relevant public and SSB	14 countries
1992 to 200	Barako, Hancock and Izan (2006)	42 12 54	Non-financial Financial Total	Voluntary disclosure	Audit committee, Board composition and board leadership structure	Audit committee and board composition	Kenya
2002	Huafang and Jianguo (2007)	559	Non-financial	Voluntary disclosure	Block-holder ownership, managerial ownership, state ownership, legal person ownership, foreign listing/ shares ownership, independent director, role duality, size, leverage, intangible assets and auditor reputation	Block-holder ownership, foreign listing/shares ownership and size	China
2003 or 2004	Zeghal, Mouelhi and Louati (2007)	33 9 41 46 21 150	Software Hardware Technology Biotechnology Traditional Total	Research (R) and development (D) disclosure	Size, leverage, listing status, R and D intensity, R and D partnership agreement, R and D accounting policy, board independence, and separation of the CEO and board chair roles	Size, R and D intensity, R and D partnership agreement and separation of the CEO and board chair roles	Canada

Table 2.1 (Continued)

Year of study	Author	Sample of Co. No. of Co.	Type of Co.	Dependent variable	Independent variable	Significant variable	Country
1996, 2002	Haniffa and Cooke (2005)	139	Non-financial	Corporate social disclosure	Malay dominated board, boards dominated by executive directors, chair with multiple direction-ships, foreign share ownership, size, profitability, multiple listing, type of industry and gearing	Malay dominated board, boards dominated by executive directors, chair with multiple direction-ships, foreign share ownership, size, profitability, multiple listing, type of industry	Malaysia
2002 or 2003	Farook and Lanis (2005)	47	Islamic banks	Corporate social responsibility disclosure	Political and civil repression, relevant public, SSB and IAHs	Relevant public and SSB	14 countries
1992 to 200	Barako, Hancock and Izan (2006)	42 12 54	Non-financial Financial Total	Voluntary disclosure	Audit committee, Board composition and board leadership structure	Audit committee and board composition	Kenya
2002	Huafang and Jianguo (2007)	559	Non-financial	Voluntary disclosure	Block-holder ownership, managerial ownership, state ownership, legal person ownership, foreign listing/ shares ownership, independent director, role duality, size, leverage, intangible assets and auditor reputation	Block-holder ownership, foreign listing/shares ownership and size	China
2003 or 2004	Zeghal, Mouelhi and Louati (2007)	33 9 41 46 21 150	Software Hardware Technology Biotechnology Traditional Total	Research (R) and development (D) disclosure	Size, leverage, listing status, R and D intensity, R and D partnership agreement, R and D accounting policy, board independence, and separation of the CEO and board chair roles	Size, R and D intensity, R and D partnership agreement and separation of the CEO and board chair roles	Canada

Table 2.1 (Continued)

Year of study	Author	Sample of Co. No. of Co.	Type of Co.	Dependent variable	Independent variable	Significant variable	Country
2000, 2002	O'Sullivan, Percy and Stewart (2008)	200	Not classified	voluntary disclosure forward-looking information	Board autonomy, presence and quality of board committees, independent ownership and audit quality	Board committees and audit quality	Australia
2004	Li, Pike and Haniffa (2008)	100	Pharmaceuticals and Biotechnology IT Telecommunications Business and Services Media and Publishing Banking and Insurance Food Production and Beverage Total	Intellectual capital disclosure	Board composition, ownership structure, audit committee size, frequency of audit committee meetings and CEO role duality	Board composition, ownership structure, audit committee size, frequency of audit committee meetings	Hong Kong
2005, 2006	Rashid and Lodh (2008)	21	Non-financial	Voluntary corporate social disclosure	Ownership structure, imposition of regulation, board composition	Imposition of regulation	Bangladesh
	Barako and Brown (2008)	40	banks	Corporate social disclosure	Board composition, Women representation on board and Foreign national on boards	Board composition, Women representation on board	Kenya

Table 2.1 (Continued)

Year of study	Author	Sample of Co. No. of Co.	Type of Co.	Dependent variable	Independent variable	Significant variable	Country
2005	Buniamin, Alrazi, Johari and Abd Rahman (2008)	73 53 47 28 17 14 7 2 1 1 243	Industrial Products Trading/Services Properties Consumer Products Construction Plantation Technology Infrastructure Project Companies Hotel Trusts Total	Environmental reporting	The independence of board of directors, role duality, management ownership, board size, environmental sensitivity and firm size	Board size, environmental sensitivity and firm size	Malaysia
2002	Akhtaruddin, Hossain, Hossain and Yao (2009)	105	Non-financial	Voluntary disclosure	Board size, proportion of independent non-executive directors (INDs) on board, outside share ownership, family control, and percentage of audit committee members to total members on the board	Board size, proportion of INDs and family control	Malaysia
2006	Said, Zainuddin and Haron (2009)	150	Non-financial	CSR disclosure	board size, board independence, duality, audit committee, ten largest shareholders, managerial ownership, foreign ownership and government ownership	Government ownership and audit committee	Malaysia
2005	Al-Arusi, Selamat and Hanefah (2009)	201	Not classified	Financial and environmental disclosure	Ethnicity of chief executive officer (CEO), leverage, level of technology, the existence of dominant personalities, profitability and company's size	Technology level, ethnicity of CEO and firm's size	Malaysia

Table 2.1 (Continued)

Year of study	Author	Sample of Co. No. of Co.	Type of Co.	Dependent variable	Independent variable	Significant variable	Country
2007-2008	Khan (2010)	30	Private commercial banks	CSR reporting	Non-executive director, existence of foreign nationalities, women representation on the board, size, profitability and gearing	Non-executive director, existence of foreign nationalities, size and profitability	Bangladesh
2008	Abdur Rouf (2011)	15 14 10 12 15 12 15 93	Engineering Food& allied Fuel & power Textile & Jute Pharmaceuticals & Chemicals Tannery, Paper & Service Cement, Ceramics & IT Total	Corporate social responsibility disclosure	Independent director, firm size, board leadership structure, profitability and audit committee	Independent director, board leadership structure, profitability and audit committee	Bangladesh

Prior studies showed that there were mixed results between the voluntary disclosure level or social disclosure and corporate governance attributes. Gray *et al.* (2001) and Brammer and Pavelin (2004) suggested that the mixed results were due to different countries, industries, time, and the approach used to analyse the data. The increasing awareness about the volume and importance of these disclosures was not only from larger companies, but also from stakeholders and regulators.

A second limitation of previous studies was the lack of focus on corporate governance mechanisms by the financial institutions in general, and particularly by the Islamic financial institutions, such as Islamic banks. Only Farook and Lanis (2005) examined SSB characteristics and investment account holders (IAHs) as factors influencing the level of CSR disclosure by Islamic banks.

2.6 UNDERPINNING THEORY

According to Choi (1999), there is no acceptable theory to clarify the corporate social disclosure by companies. Several theoretical perspectives have been employed in CSR disclosure previous studies (Hackston & Milne, 1996). From the Islamic perspective too, there are no theories that have been developed in the area of CSR disclosure (Farook & Lanis, 2005; Maali *et al*., 2006). The empirical evidence shows that the major influence on the Islamic banks for CSR disclosure is the relevant public (Farook & Lanis, 2005).

Many theories such as political economy accounting theory, agency theory, legitimacy theory, stakeholder theory, steward theory, and resource dependence theory have been used to explain CSR disclosure and corporate governance

(Campbell, Craven, & Shrives 2003; Deegan 2002; Gray *et al*., 1995a; Guthrie & Parker, 1990; Pattern, 1992; Roberts, 1992; Tsang, 1998; Wilmhurst & Frost 2000).

2.6.1 Political Economic Theory

The main notion of political and economic theory is that all political, economic and social contexts work together in the environment of social disclosure (Guthrie & Parker, 1990). Political economy theory is emphasized on the political, social and institutional framework in which the economy takes place, rather than focusing on the economic self-interest and profit-maximization of the organization individually (Gray *et al.*, 1995b). Based on this theory, corporations disclose social and environmental information in order to respond to government or societal pressure (Guthrie & Parker, 1990). Political economy theory perceives accounting reports as social, political, and economic documents, and it considers the employment of social and environmental information as a strategic tool in achieving the organizational objectives (Guthrie & Parker, 1990). Therefore, corporations are likely to build CSR disclosure to reveal a positive response to particular pressure groups within the community to avoid potential regulations regarding its disclosure.

2.6.2 Agency Theory

Agency theory suggests that there is a separation between the ownership and control of a company. In the company context, the agent (manager) represents the principal (shareholder) (Eisenhardt, 1989; Fox, 1984; Jensen & Meckling, 1976). Jensen and Meckling (1976) set a framework that relates both disclosure and CG as a mechanism of accountability. This theory states that a potential conflict between shareholders and managers exist due to different interests related to various managerial methods and risk management. Managers will undertake the decisions that achieve their own interests in the existence of information asymmetry (Cerbioni & Parbonetti, 2007). Disclosure can alleviate agency costs between shareholders and management as well as information asymmetries in transactions (Cerbioni & Parbonetti, 2007; Jensen & Meckling, 1976).

Based on agency theory, management tends to disclose social information to reduce agency costs that exist between the principals (owners) and the agents (managers) because of their conflict of interest (Hossain *et al*., 1995). In other words, the major view of agency theory proposes that managers prefer to disclose social information to increase their well-being when the benefit from the disclosure is higher than the costs (Ness & Mirza, 1991).

2.6.3 Stakeholder Theory

The concept of a stakeholder is based on the idea that the behaviour of different stakeholder groups motivates management to identify its needs according to the environment surrounding it. Freeman (1984) defined a stakeholder as "any group or individual who can affect, or is affected by the achievement of an organization's objectives" (p. 46), and he stated that direct and indirect stakeholders should be identified by corporations. Thus, the stakeholder perspective is concerned generally with the manner in which a corporation controls its stakeholders (Gray, Dey, Owen, Evans, & Zadek, 1997), which is derived from the strategic posture adopted by the organization (Ullman, 1985). The corporation's strategic posture is defined as "the mode of response of an organization's key decision-makers towards social demands" (Ullman, 1985, p. 552).

2.6.4 Stewardship Theory

Stewardship theory is derived from the idea that a steward should be more cooperative, more pertinence towards the corporation than self-serving. The theory supposes a higher relationship between the achievement of the corporation and the satisfaction of the principal. Hence, a steward believes that by working collectively in a corporation, at the end, he could also achieve his personal needs. Stewardship theory assumes that executive managers have more incentives to act in the best interest of the organization than for their self-interests.

According to this theory, executive managers are more interested in ensuring the survival and achievement of the organization. The relationship between the BODs and top management is considered a relationship between principal and a steward instead of between principal and agent. Managers as stewards of a company, they are basically supposed to be reliable persons and thus trustworthy stewards of the resources consigned to them, which creates more monitoring (Donaldson and Davis, 1991). Within this theory, shareholders are free to sell their stocks at any time. Different investors are less concern regarding risk at the corporation's level, as the management assumes exceptional risk as long as the return is appropriate. When a company is in a difficulty, executive managers cannot leave their works but instead have put all their attention in maintaining the company continued survival. Therefore, according to stewardship theory, in many cases, top management gives more attention on the firm's long-term achievement rather than on short-term oriented shareholders (Monks & Minow, 2004).

2.6.5 Resource Dependence Theory

Resource dependence theory is another theory employed in CG research (Pfeffer & Salancik, 1978). The main idea of this theory is that corporations try to extend control completely on their environment by harnessing the resources required to continue their survival. The concept of harnessing the resources has important implications for the BOD's role and its attributes.

Boards are important because they can be hired as a mechanism to engage with the outside environment. Inter-organizational connections through the appointment of external directors and BOD interlocks can be utilized to control environmental unforeseen events. Directors who are reputable in their occupations and societies can be a source of timely information for executive managers. According to Price (1963), directors can influence other constituencies to work in the interest of the corporation. Pfeffer and Salancik (1978) stated that "when an organization appoints an individual to a board, it expects that the individual will support the organization, will concern himself with its problems, will favorably present it to others, and will try to aid it" (p. 163). This support would lead to improve organizational performance, and maximize shareholders' wealth. The BOD role comprises creating connections and increasing finances, which reflects the best composition of the board (Pfeffer, 1972).

2.6.6 Legitimacy Theory

Legitimacy theory and stakeholder theory are neither separate nor competitive, but they have been developed from the broader political economy viewpoint (Deegan, 2002; Gray *et al,* 1996). This perspective sees accounting reports as political, economic and social records. Therefore, both theories act as the tool to build, maintain, and legitimize political and economic regulations, organizations, and ideological groups, which add to the benefits of the company. According to Guthrie and Parker (1990), disclosures have the capability to transfer the political, economic and social meanings for a pluralistic set of people or groups receiving the report.

While there is no generally accepted theory for explaining CSR disclosure practices, legitimacy theory has considered one of the major quoted theory in the area of social and environmental accounting (Campbell *et al*., 2003; Deegan, 2002). According to legitimacy theory, a corporation discloses CSR information in order to establish or sustain its legitimacy by obtaining the community acceptability of its actions (Deegan, 2002). In other words, based on legitimacy theory, the level of a company's CSR disclosure is a response to the pressures by the public. In fact, the majority of recent studies on CSR utilize legitimacy theory (Brown & Deegan, 1998; Deegan & Rankin, 1997; Guthrie & Parker, 1989; Patten, 1992), which is used to explain disclosures with regard to the environmental and social behaviour of organizations (Campbell *et al.*, 2003; Hooghiemstra, 2000). Furthermore, Gray, Kouhy and Lavers (1995a) argued that legitimacy theory has an advantage over other theories in providing disclosure strategies. According to Ullman (1985), while stakeholder theory states that the company and management work in conformity with the needs and pressure of its different stakeholder interests, legitimacy theory concentrates on the firm's transactions with the community as a whole. Finally, in the legitimacy theory context, social and environmental disclosure is seen as a way to legitimize a company's continued presence or operations in the community (Gray *et al*., 1995a; Hooghiemstra, 2000). For these reasons, this study adopts legitimacy theory as the theoretical framework for the objective of explaining variations and determinants of CSR disclosure within Islamic banks**.**

2.6.6.1 Legitimacy Theory, Corporate Social Responsibility and Islam

According to Deegan (2002), legitimacy theory is considered to be systems-oriented theory such as stakeholder and political economy theories, which suggest that individuals, regulations, and corporations, looking to protect their own self-interest, try to act and react in the system through a variety of relationships with other stakeholders (Williams, 1999). The entity that works within a system-oriented perspective is supposed to be impacted by, and consecutively, to have influence on the community in which it operates. The relations between individuals, corporations, and community are seen as 'social contracts' (Deegan 2002; Williams, 1999). The legitimacy, political economy, and stakeholder theories also emphasize that the representatives, whether they are persons or organizations, in this system have the right to follow their own objectives and self-beneficiaries (Williams, 1999, p. 211). On the other hand, these rights to self-interest are moderated by the political and social environment in which they interact (Roberts, 1992; Williams, 1999).

According to Farook and Lanis (2005), this notion is said to be in harmony with the concept of *Tawhid* (Monotheism) which is the Oneness of *Allah* (God) as the highest principle of Islam (Choudhury & Hussain, 2005). This concept entails that there is only One God who is the Creator, Owner (of humans and non-humans) and Source of all things. It implies that all Muslims are accountable before *Allah* for everything that he or she does (Hameed, 2001; Maali *et al*., 2006). Since *Allah* has created everything in the universe, humans have been granted ownership over resources as trustees and they must use their resources according to the instructions given by *Allah*. This situation of trust is the basis of responsibility for persons and organizations and it necessitates total submission to *Allah* in all aspects of life, including economic activities (Hameed, 2001).

Islam grants humans the right to use, not the right to own. The real difference between these two is that the right to own grants the right to use any way the Owner wants to, while the right to use puts restrictions and obligations as defined by the Owner. This right to use in Islam, however, is granted to private individuals. Islam is given the responsibility of ensuring that private individuals comply with their duties and fulfil their obligations in using the resources. As such, Islam grants men's rights the freedom to the use of resources, and ensures its appropriate utilization by imposing duties and responsibilities on this right. The concept of right to use in Islam also covers a number of activities that are prohibited, such as gambling, drugs, and drinking alcohol, which will bring negative effects on families and on society at large.

Since organizations are part of a broader social system, they play an important role through their status of responsibilities in society. According to Deegan (2002), organizations survive to the degree that the specific community believes that they are legitimate. In terms of organizational relations with a community, legitimacy theory has been developed by stating that "organizations continually seek to ensure that they operate within the bounds and norms of their respective societies" (Deegan, 2000, p. 253). In this context, organizational legitimacy is defined as:

> "Organizations seek to establish congruence between the social values associated with or implied by their activities

> and the norms of acceptable behaviour in the larger social system in which they are a part. In so far as these two value systems are congruent we can speak of organizational legitimacy. When an actual or potential disparity exists between the two value systems there will exist a threat to organizational legitimacy" (Mathews, 1993, p. 350).

Based on the above argument, legitimacy may be viewed 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" (Suchman, 1995, p. 574). During the seventies, Bowman and Haire (1976, p. 13), as cited by Farook and Lanis (2005) defined corporate social responsibility mainly as "including the concern for the impact of all the corporation's activities on the total welfare of society". This means that the corporations are influenced by the broader community in which they operate (Deegan 2002; Farook & Lanis 2005).

In Islam, the corporate social responsibility concept emerges from social contracts that are necessarily related to the consistency of the value system of the organization to the broader value system of an Islamic community. In the Islamic context, organizations are similarly, if not further more so, responsible for the community as are persons. Lewis (2001) amplifies the circumstances for business organizations, being that "both managers and providers of capital are accountable for their actions both inside and outside their firms; accountability in this context means accountability to the community" (p.113) to set up socio-economic justice in their own capability. The basic objective of *Shariah*, which governs all aspects of life, is to ensure general human welfare and socio-economic justice. Because the *Shariah* governs all aspects of life, Muslims, for example, are not allowed to invest in business considered non-*halal* (lawful) or forbidden by Islam, such as the sale of tobacco, alcohol and pork; lotteries; races; gambling. Muslims are prohibited from taking or offering *Riba* (usury), which stems out of principles of socio-economic justice. According to Gambling and Karim (1991), within a larger perspective, *Riba* contains any unjust dealing practice. The forbidden of *Riba* is derived from the ruling of not exploiting the needy and the poor by imposing interest on loans offered to them which is explained as a type of unfairness (Al-Buraey, 1990; Mannan, 1986). According to El-Ashker (1987), the prohibition of *Riba* is derived from the fairness principles, hard work, and the avoidance of wealth being condensed in a few hands, and allows it to be more broadly distributed. One of the major objectives of Islamic economic justice is that wealth should be circulated broadly in the society and not condensed in a few hands. The *Shariah* requires Muslims to pay the wealth tax *Zakah*. According to Mannan (1986), *Zakah* includes the ethical, economic, and social sphere of Islamic finance. In the ethical domain, *Zakah* cleans away the acquisitiveness and greed of the rich, whereas socially it works as a sole determinant to eliminate poverty from the community through heartening the rich in practicing its responsibilities (Mannan, 1986). From the above discussion, it is concluded that norms, values, and beliefs of the Islamic business system in general are congruent with the concept of CSR.

2.6.6.1.1 CSR Disclosure from an Islamic Perspective

In the Islamic perspective, accountabilities of the Islamic business organizations are similar to the individual social responsibility of each Muslim based on the *Shariah* rules and principles. Islamic business organizations have also an accountability to follow the *Shariah* in all aspects of their transactions. This is because they perform a religious role in a society as they represent various stakeholder groups.

The disclosure from an Islamic perspective refers to two means: full disclosure and social accountability (Othman *et al*., 2009). The concept of social responsibility is associated with the principle of full disclosure (Muwazir *et al*., 2006; Othman *et al*., 2009). In the context of Islam, social reporting of Islamic business organizations is one way to provide full disclosure. Based on this point, the main objective of corporate social disclosure by Islamic business organizations is to show conformity with *Shariah* rulings (Maali *et al*., 2006; Muwazir *et al*., 2006; Othman *et al*., 2009). The second goal of social disclosure perhaps comprises those similar to features as contained in the models of the West, like helping decision-makers in making the right economic decisions; however, these objectives are secondary from an Islamic perspective (Maali *et al.*, 2006). The main objective of social reporting in Islam is the one adopted by AAOIFI when setting the statement of objectives of financial accounting for Islamic banks and financial institutions. The full disclosure does not mean that Islamic business organizations such as Islamic banks disclose any type of information. It means disclosing all information necessary to the Islamic society (*Ummah*) about their transactions. Relating to the concept of disclosure is the concept of accountability, which means that within the Islamic context, Islamic society has the right to know the influence of transactions of Islamic business organizations on its welfare.

Within the Islamic context, the disclosure of truth is an important duty to both businesses and individuals in their actions since *Allah* is omniscient, and the Qur’an emphasizes on this duty in many verses. For example, *Allah* says in the Qur'an: "...and cover not the truth with falsehood nor conceal the truth when you know" (the Qur'an, 2: 42). Also *Allah* says: "I know what ye reveal and what ye hide" (the *Qur'an*, 4:33) and as well, "*Allah* knows what is manifest and what is hidden" (the Qur'an, 87:7). On the other hand, because responsibility to *Allah* contains a responsibility to the community, the duty of the disclosure of truth is owed to the Islamic society (*Ummah*) as far as to *Allah*. Islamic business organizations are responsible for their activities to the community in which they operate, since their activities influence the welfare of the community. Islamic business organizations also are obliged, at the same time as persons, to practice charitable actions, both mandatory and voluntary, to assist the poor and needy individuals, and this duty is accented by several verses of the Qur'an as well as the *Sunnah*. *Allah* says in the *Qur'an* (9:103): "of their goods take alms that so thou mightiest purify and sanctify them". Corporate social reporting of the Islamic business organizations provides additional information more than showing compliance with the *Shariah*; it should provide information about transcendental, ethical, moral, and other religious requirements, such as prohibition of *Riba,* and payment of *Zakah,* which helps Muslims in practicing their religious obligations.

Based on the above discussion, there are three broad objectives for corporate social disclosure of Islamic business organizations:

1- To show conformity with the *Shariah* rules and principles, specifically dealing justly with various stakeholders like employees, clients, and creditors.
2- To show the effect of Islamic business organizations' transactions on the welfare of the Islamic community (*Ummah*).

3- To help Muslim investors to perform their religious requirements, such as the payment of *Zakah*.

2.6.6.1.1.1 CSR Disclosure as Means of Legitimization in Islam

The framework for CSR in Islam is based on the *Qur'an* and *Hadith* (teachings of Prophet Muhammed), derived from the congruence between the ideals of social responsibility and accountability and business operations in Islam. Haniffa and Hudaib (2001) asserted that the importance of disclosure and presentation is to fulfil the duties and obligations based on the principles of *Shariah*. The Islamic banks are expected to disclose at least: (1) any forbidden transactions they made; (2) *Zakah* obligations they have to pay and have already paid; (3) social responsibility, if not all information that is relevant to CSR. The involvement of this situation is that Islamic banks must provide any information needed to the *Ummah* (Islamic society) about their transactions. Since organizations are part of the *Ummah*, the *Ummah* has the right to know how institutions disclose activities that affect welfare in the society.

The main objective of Islamic banks is not to achieve the performance goal (maximize wealth for shareholders), but more importantly, to achieve socially objectives through contracts with different groups of stakeholders. Based on this point, Wartick and Cochran (1985) stated that:

> "Because corporate behavior is so critical to the realization of social goals such as equal opportunity, worker safety and health, and environmental protection, a social dimension is added to corporate performance . . . To view the modern corporation in a strict economic sense is to ignore reality, and to suggest that its responsibilities include only economic obligations is myopic" (p. 740).

This does not mean that Islamic banks do not seek the profits that are necessary to business survival, but this goal must comply with the *Shariah* principles, and Islam requires the Islamic organizations to make reasonable profits.

Social responsibility disclosures are important to show how the institutions have been thriving in releasing its deal with different groups of stakeholders such as employees, customers, government, and society as a whole. Therefore, Matthews (1997) asserted that the company would disclose further information to establish its moral nature, to meet the implied social deal between an organization and the community, and to legitimize the corporation in the public eye. This means is supported by Gray *et al*. (1987), who stated that the management of a firm provides social information in the annual report as a result of the social contract.

The concept of the social contract is extremely in line with the corporate social responsibility in *Shariah*. In the Islamic context, corporations are accountable for their behaviour to achieve both the socio-economic justice and welfare for the community.

Conforming to Gray *et al.* (1995a, p. 53), social disclosure is viewed as "a source of the information flow between the corporation and the stakeholder groups as well as the society as a whole". The Islamic organizations as a member of that society are likely to provide more information about their activities through the boundaries of what are considered agreeable by that society. However, legitimacy theory explains how management of the organization will react to community expectations and act to legitimize their activities (Guthrie & Parker, 1989; Patten, 1992; Tilt, 1994).

Legitimacy theory is implemented where organizations adopt appropriate organizational frameworks and practices related to the social criterion or values of society (Meyer & Rowan, 1977). From this perspective, the firms use corporate social disclosure as one of the policies to seek acceptance and approval of their actions from the community (Branco & Rodrigues, 2008b). Corporations also employ social disclosure as a main tool in the legitimizing policies to maintain their legitimacy.

The above arguments lead to the conclusion that the Islamic banks must provide information about their objectives, vision and mission, which must be consistent with the essential objectives of their formation of the Islamic banks, which are to realize social welfare. In addition, the Islamic banks must disclose all their principals used in the social activities, which must comply with the *Shariah* rulings.

Disclosing CSR information in the annual reports of Islamic banks is based on the relationships that exist between the organizations, government, people, and other stakeholder groups, and generally, the *Ummah*. The main factor that will clearly affect the disclosure level of CSR by the Islamic banks is the relative size of the Muslim population as a measure for the Islamic community founded on legitimacy theory (Farook & Lanis, 2005). Therefore, the size of the community tries to catch the relevant public concept in which the organization needs legitimizing to survive (Farook & Lanis, 2005).

Legitimacy theory has been used by researchers, who sought to investigate social responsibility since the 1980s. Researchers have agreed that legitimacy theory viewed social disclosures as a significant factor in the company's continuance of its liberty, position, and reputation with powerful communities or stakeholder groups (see, for example, Honger, 1982; Roberts, 1992).

Honger (1982) examined the social reporting of US Steel Company, and his findings tend to support legitimacy theory. In another longitudinal study conducted in an Australian environment, Guthrie and Parker (1989) explored the social disclosure of the firm BHP. Guthrie and Parker (1989) concluded that legitimacy theory did not adequately appear to provide an explanation for the variations in the disclosure.

Many studies have adopted legitimacy theory as a theoretical basis for understanding the corporate social disclosure (Adams, Hill, & Roberts, 1998; Brown & Deegan, 1998; Deegan & Rankin, 1996; O'Dwyer, 2002; Patten, 1992; Wilmshurst & Frost, 2000). Some of these studies show a positive link between corporate social disclosure and legitimacy motivation (Brown & Deegan, 1998; Deegan & Rankin, 1996; Patten, 1992). In contrast, other researchers found that legitimacy theory has no correlation with social disclosure (Adams *et al*., 1998; O'Dwyer, 2002; Wilmshurst & Frost, 2000). These findings may be due to the differences in strategies adopted by firms to legitimize their behaviour (Newson & Deegan, 2002).
Gray *et al*. (1995a) stated four broad legitimized strategies as proposed by Dowling and Preffer (1975) and Lindblom (1994) when organizations faced a threat to their legitimacy. First, the corporation may attempt to teach and notify its "relevant public" about alterations in the corporation's performance and actions. Second, the corporation may seek to change the perceptions of the relevant public, but not change its activities. Third, the organization may seek to manipulate the awareness by

diverting attention from the problem being concerned by the public to other related problems. Fourth, the corporation may attempt to alter public prospects of its performance.

Branco and Rodrigues (2008b) argued that CSR is viewed as one of the main tools in legitimizing policies employed by corporations to get acceptance and approval of their actions from the community. Furthermore, Deegan (2000) stated, in the organizational legitimacy theory context: "organizations continually seek to ensure that they operate within the bounds and norms of their respective societies, that is, they attempt to ensure that their activities are perceived by outside parties as being legitimate" (p. 253).

Since legitimacy revolves around the notion of managing the social expectations, social responsibility disclosure reflects the level of congruence between social expectations and activities of a company that a company does to legitimize its activities. The link between activities of a company and the society is supported by Lewis (2001), who argues "that both managers and providers of capital are accountable for their actions, both inside and outside their firms; accountability in this context means accountability to the community" (p.113).

Because the main objective of this research is to investigate the CSR information disclosure by the Islamic banks, the size of the Muslim population may affect the activities of an Islamic bank in an Islamic society, where an Islamic bank seeks to legitimize their activities for its continued existence. The researcher believes that legitimacy theory is more appropriate for this study.

2.7 SUMMARY

The literature review focused on the various prior studies that investigate the extent and level of CSR in both conventional and Islamic financial institutions, and the influence of corporate governance attributes on CSR disclosure. Particularly, the review of literature addressed: the definition and evolution of CSR, the concept of CSR from an Islamic perspective, the extent, the level and the determinants of CSR, and then, the underpinning theories.

The next chapter of this thesis explains the hypotheses development and research methodology employed in the study to determine the influence of corporate governance mechanisms and firm characteristics related to CSR disclosure, and addressing the means of a good research study, which comprises the theoretical framework, hypotheses development, research design and research method, population and sampling, and variables measurement.

CHAPTER THREE

THEORETICAL FRAMEWORK AND HYPOTHESES DEVELOPMENT

3.1 INTRODUCTION

This chapter presents the theoretical background of the study. The arguments and discussions that lead to the development of the hypotheses are also incorporated. Following this, the research design and research methods that structure the foundation of the research are briefly described. Lastly, the measurement of variables is explained. The following section of the chapter briefly describes the theoretical framework of the study.

3.2 THEORETICAL FRAMEWORK

Legitimacy theory is the primary commonly-used theory in corporate social disclosure studies (Gray *et al*., 1995), which is derived from the idea of social contract. The management's incentives have been studied within the framework of legitimacy theory (Deegan, 2002). Related to legitimacy theory, CSR disclosure is a way to legitimize a corporation's action by disclosing information aimed to influence stakeholders' and ultimately, society's perceptions about the corporation (Hooghiemstra, 2000). Legitimacy gaps occur when a community's expectations of the company's activity vary from the community's perceptions of its activity. Legitimacy perspective proposes that firms employ CSR disclosure as a tool of communicating disclosure to societal pressure. The variations in the level of CSR disclosure are a systematic role of variations in community pressure meeting individual corporations (Patten, 2002). In the context of legitimacy theory, corporations employ CSR disclosure as a response to the societal pressure. Boulding (1978, cited in Walden & Schwartz, 1997) asserted that social pressure contains three non-market environments; (1) the cultural environment, which includes the values and attitudes of the general population; (2) the political environment, which generates new laws and sanctions; and (3) the legal environment that comprises laws and regulations. According to Suchman (1995), the broad concept of legitimacy theory refers to firms, management, performance measures, and stakeholders' needs, which are elements within a larger cultural framework that create demands on each other.

Disclosure in the corporate annual reports is one of the effective channels to communicate with stakeholders when there is a legitimacy gap. In both Islamic and non-Islamic countries, the governments and public gave more attention to social activities when a possible legitimacy threat is seen in financial institutions, particularly those operating according to the teaching of the *Shariah* (Farook & Lanis, 2005). Consequently, the Islamic banks need to provide information to the community about their concern for social issues. Disclosure would prove that they are *Shariah* compliant. Therefore, the importance of Islamic social reporting sets in.

Social and environmental research that includes disclosure has existed for many decades (Deegan, 2002: Gray, 2002: Mathews, 1997). In recent years, disclosure of CSR has been the area of considerable academic accounting studies (Farook & Lanis 2005; Gray *et al*., 1987; Haniffa & Hudaib 2007; Maali *et al*., 2006). This is due to the growth of communication between different stakeholder groups and business organizations in society.

A number of previous empirical studies have analysed the social disclosure types; several of which study either the corporate annual reports form or different social, environmental reports that researchers have employed content analysis technique to measure social information. There is evidence from these studies both social and environmental disclosure might be influenced by corporate governance attributes (Barako & Brown, 2008; Halme & Huse, 1997; Haniffa & Cooke, 2005; Rashid & Lodh, 2008; and Said *et al*., 2009).

The majority of prior studies have excluded banking and finance companies from their sample because of the strict regulatory standards related to this industry (Barako & Brown, 2008). In contrast, scarce studies have been focused on the type and extent of CSR disclosure in the banking sector, particularly Islamic banks.

Figure 3.1 presents a suggested framework of research that underpins this study. The research framework of the study shows that the dependent variable of CSR disclosure by Islamic banks has influenced by two groups of independent variables; namely, the socio-political context variable (relevant public), and corporate governance mechanisms, including control variables of the firm's characteristics that might possibly contribute in developing the theory. CSR disclosure is measured by capturing any form of social information in the annual report of an Islamic bank. To achieve this, the researcher developed a CSR disclosure checklist and decision rules based on previous studies (Haniffa & Hudaib, 2007; Maali *et al*., 2006; Muwazir *et al*., 2006). The study expects that certain corporate governance characteristics may lead banks to disclose social information. The development of hypotheses is discussed in the following section.

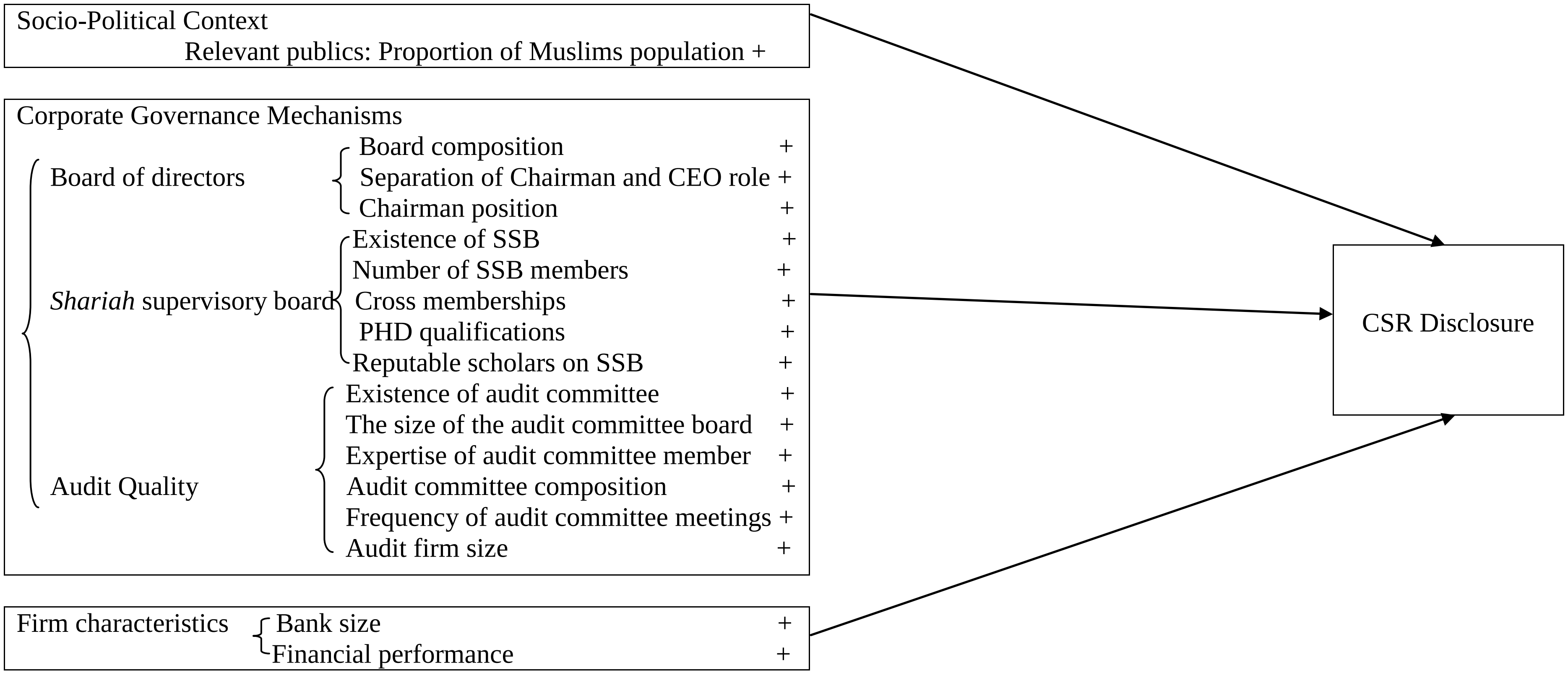

Figure 3.1

Research Framework

3.3 HYPOTHESES DEVELOPMENT

Prior studies have investigated the influence of determinants of corporate governance mechanisms (SSB attributes, firm characteristics, and board of directors' elements) on social disclosure practices (Farook & Lanis, 2005; Hamid, 2004; Haniffa & Cooke, 2005; Khan, 2010; Othman *et al*., 2009; Smith *et al*., 2007).

Several empirical studies have found an association between CSR disclosure and a variety of corporate governance attributes. Barako and Brown (2008), Haniffa and Cooke (2005), and Khan (2010) found that the CSR disclosure is significantly related to stronger corporate governance in the form of more non-executive directors on the board because non-executive directors are more independent from the management and have power to enforce the top management to provide disclosure. In the same vein, Forker (1992) found that the separation between the CEO and chairman, and the chairman's independence enhances the corporate governance quality, and thus improving disclosure quality. The separated role gives the required checks and balances of power and authority managers' behaviour. The existence and characteristics of the SSB and relevant public increased the monitoring quality and then improved the disclosure level of CSR (Farook & Lanis, 2005). During investigating the relationship between the disclosure level of CSR and audit quality, Cohen and Wright (2009) and O'Sullivan *et al.* (2008) found that the audit committee with its characteristics and external auditor to be important factors in explaining the disclosure level.

Based on the previous discussion, it can separate between three types of determinants of CSR disclosure (see Figure 3.1), which are:

Firstly, socio-political context factor; relevant public that explains that the extent of an Islamic bank's CSR disclosure is responding to society pressures based on legitimacy theory.

Second, it can be argued that corporate governance mechanisms will define how Islamic banks are concerned about their CSR activities, and therefore, the disclosure level of CSR. These mechanisms contain the board of directors effectiveness, the effectiveness of SSB and audit quality. It can be argued that well-governed Islamic banks tend to disclose more CSR information in responding to public pressure.

Third, it includes two firm characteristics, namely: size and financial performance, as control variables. According to legitimacy theory, it is argued that large and profitable banks tend to disclose more information of CSR (Zain & Ganggu, 2006), in order to legitimize their operations in responding to public pressure.

3.3.1 Socio-Political Context: Relevant Public: Relative Size of Muslim Population

Prior studies documented that the extent of CSR disclosure is related to the external pressure exerted by the community (Deegan & Rankin, 1996). On the level of an intermediary, an organization grows within a society. While corporation's activities influence the quality life of citizens, the existence of a company is dependent on the ability to legitimize its activities to the community. A way to derive the concern of the community, sociall and environmentally, is the socio-political context factor, the relevant public (society) that an organization is facing (Farook & Lanis, 2005), which represents the public pressure.

In the context of legitimacy theory, Islamic banks act in an extensive social environment that may influence the flow of information in a specific country. The relative size of the Muslim population as a measure for the public pressure of the Islamic community (*Ummah*) will determine the extent of CSR information disclosed in annual reports of Islamic banks.

The empirical evidence showed that the “relevant public” is the most important determinant of CSR that appears to be directly related to the management (Newson & Deegan, 2002). In the case of Islamic banks, the main “relevant public” is society itself.

Management uses CSR disclosure as a technique to influence the society’s expectations and perceptions (Deegan & Rankin, 1996). While an Islamic bank operates in a particular country, and within that country, there may be limited expectations about social responsibility and accountability, and if the bank also relies on encouragement from the Islamic community, at that time, it should comply with societal expectations (Farook & Lanis, 2005).

Despite the fact that there may be native variations in disclosure across countries due to diverse cultural and other determinants, governments in the Islamic countries and international regulatory institutions as AAOIFI should work together to adopt similar CSR disclosure policies for Islamic banks (Farook & Lanis, 2005). Consistent with this view, Maali *et al*. (2006) pointed out that Islamic banks claim to comply with *Shariah* principles and rules that are needed to create definite global voluntary disclosures, which exceeding local requirements derived from responsibility to the Islamic community.

The multiplicity and power of the "relevant public" determine the actions of the banks that align these worldwide expectations of CSR disclosure held by the society in which they operate. Equally important, Farook and Lanis (2005) found that the "relevant public", which includes a great proportion of Muslims from the population in a country, is putting more influence on the Islamic banks to legitimize their CSR activities with different stakeholder groups within the social and political environment. Therefore, this argument leads to the following alternative hypothesis:

H_1: There is a positive relationship between the proportion of Muslim population and the disclosure level of CSR in annual reports of Islamic banks.

3.3.2 Corporate Governance Mechanisms

According to Dahya, Lonie and Power (1996), corporate governance can be described as "the manner in which companies are controlled and in which those responsible for the direction of the companies are accountable for the stakeholders of these companies". It includes "a set of relationships between a company's management, its board, its shareholders and other stakeholders" (OECD, 2004). The role of management in governing is to be responsible for the whole life of the institution by taking into account all the groups that influence its viability, competence and ethical nature (Selznick, 1992). The legitimacy of a company's power and a firm's responsibility are the main governance issues to whom and for what the company is accountable, and by what its requirements are to be determined and by whom (Worthy & Neuschel, 1983). Corporate governance comprises the controls and procedures that exist to ensure that management works in the shareholders' interest, to reduce the expectation that management behaves in its self-interest, and takes on behaviours that deviate from maximizing the firm's value. The mechanisms of corporate governance influence the extent of information provided by the firms to their shareholders (Kanagaretnam *et al*., 2007).

Welker (1995) argued that the separation between the ownership and management reduces the agency problem, since agency theory gives a structure for connecting disclosure behaviour to corporate governance. Examining the voluntary disclosure level made in the annual report is based on the level of corporate governance practices of a firm. Therefore, a high level of disclosure is expected to give more exhaustive monitoring for a company to decrease agency problems and investor uncertainty.

From the Islamic perspective, the framework of corporate governance is quite distinctive under Islamic banks, because the bank must follow a different set of principles based on the *Holy Qur'an* and the Sunnah. According to Bhatti and Bhatti (2009), *Shariah* scholars stated that the concepts of Islamic corporate governance and corporate social responsibility (CSR) were quite similar. The fundamental objective of Islamic financial institutions such as banks is to comply with *Shariah* principles, which contains elements of social justice and accountability (Farook & Lanis, 2005). In the context of Islam, the ethical objectives of the community must be incorporated into Islamic banks' objectives and policies. Accordingly, Hassan and Abdul Latiff (2009) asserted that CSR is a primary condition of Islamic banking transactions. Actually, CSR has been incorporated in the Corporate Governance standard of AAOIFI (Governance Standard for Islamic Financial Institutions No. 7: Corporate Social Responsibility Conduct and Disclosure for Islamic Financial Institutions). The *Shariah* rulings and the principles of Islamic economy and finance principles must be considered to determine the suitable structure of corporate governance for Islamic banks. *Zakah*, prohibition on *riba*, prohibition on *gharar*, prohibition on hoarding, and economic systems based on the profit and loss sharing are the major principles of Islamic economics, which affect the corporate governance structure. All these principles influence the corporate governance structure of Islamic banks. The Islamic corporate governance structure is derived from the structure of conventional corporate governance, but based on the ethical codes of the *Shariah*.

The model of corporate governance for Islamic banks is supposed to be grounded on the principle of property rights in Islam; the system that is set must comply with *Shariah* rulings, and it must be based on the protection of stakeholders' rights, which consists of shareholders, investors, creditors, employees, and the society as well (Bhatti & Bhatti, 2009; Hasan, 2008). According to Grais and Pellegrini (2006a), the unique attributes of Islamic banks must be clarified in order to give a regulative structure that supports the development of their corporate governance. Both the existence of the *Shariah* supervisory board (SSB) and the *Shariah* review unit is one of the major important differences between the structure of corporate governance for conventional banks and Islamic financial institutions (Grais & Pellegrini, 2006b).

The main objectives of the SSB are to guide Islamic banks in the settings of policies and systems based on the *Shariah* principles, approving their financial dealings that are lawful, and preparing their agreements for future contracts that comply with

Shariah (Daoud, 1996). The SSB is independent from the board of directors (BOD), and it is permitted to be present at the BOD meetings to argue the religious aspects of their decisions. The authority of the SSB comes from religious and legal resources, since it represents the bank in the community and explains any religious distrust that the stakeholders might have about any transactions. The SSB also conducts internal audits regularly to ensure that all documents of Islamic banks are prepared according to the *Shariah* rules.

The justifications for considering corporate governance is that weak reporting and disclosure practice might originate from governance. Since reporting is a medium of communicating the information to the stakeholders, so they can subsequently take the right managerial decision. From the bankruptcy filing of WorldCom, Enron, Global Crossing, and UAL Corp, external auditors play a vital role in society. In other words, external auditors act as gatekeepers who supervise managerial activities on the firm stakeholders' behalf (O'Sullivan *et al*., 2008).

Islamic banks as ethical enterprises are assumed to set significance concern on moral values. Therefore, in the last decade, Islamic banks have been spared from the collapse of conventional banking due to the weakness of corporate governance. According to Grais and Pellegrini (2006b), the reasons behind those failures are the board of directors' collusion with the top management, the collapse of auditing, and extreme risk-taking by management.

Responding to these scandals, organizations have taken steps to strengthen their governance, not only by making the board of directors more independent, but also by enhancing corporate transparency through the adoption of higher disclosure requirements (Hauswald & Marquez, 2006).

Strong corporate governance of a bank is a crucial component for the improvement of the Islamic finance industry. The Islamic finance regulations must be consistent with *Shariah* principles and rules. Furthermore, it can also adopt the international corporate governance standards that are in compliance with the *Shariah*. Governments of Islamic countries have responsibilities to ensure that all corporate governance requirements are based on *Shariah* principles and rules.

The Code of Best Practices for Corporate Governance in Islamic Financial institutions (Chapra & Ahmed, 2002), Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services (IFSB, 2006) and the standards of AAOIFI have set up corporate governance devices to improve transparency and accountability. Corporate governance comprises a number of practices containing: a requirement of size of the board, independent directors' board, separation of CEO and board chairman, a requirement for the *Shariah* supervisory board, and an audit committee (AAOIFI, 2009; IFSB, 2006).

Positive corporate governance is much more than a great concept. It supports the construction of capital, reduces the capital costs, develops the climate of investment, and assists to create good markets. Therefore, the participants in the market with an earned interest contribute in improving the sustainable national capital markets, which can also play a role in elevating governance requirements by adoption the expectations of market for what is considered preferable corporate behaviour.

Forker (1992) debated that the adoption of internal management mechanisms such as board's independence, separation of the function CEO and chairman, and an audit committee, enhance the quality of monitoring and reduce the possibility of withholding information, and as a result improving the disclosure quality. Weak disclosure practice in an organization may occur due to the weak corporate governance, and an increase in company's disclosure and transparency will guide to improve corporate governance (Chen *et al*., 2006).

In the corporate governance context, the board of director structure seems to be a significant mechanism that could impact corporate actions, and as such, the board of directors is considered an important factor of corporate governance (Bhagat & Bolton, 2008). According to Halme and Huse (1997), the social pressure may lead the board of directors to guide the corporation to behave in a socially accountable way.

The board of directors may lead to higher monitoring, and as a result to the great disclosure level of CSR and the extent to which the board will affect CSR disclosure may also rely on the attributes of this corporate governance indicator. Hence, the characteristics of the board (board composition, separate role between CEO and chairman, and chairman position) can be viewed as mechanisms of corporate governance (Forker, 1992; Hauswald & Marquez, 2006). On the other hand, the above discussion can draw on the *Shariah* supervisory board (SSB). Because the authority of the SSB is to ensure conformity of the Islamic banks with *Shariah* principles and rules, they can play an important function in mandating CSR behaviour and disclosure of CSR (Farook & Lanis, 2005). Nevertheless, the degree to which the SSB impacts CSR disclosure relies on the role of SSB in supervision on the investors' behalf, and on the characteristics of this corporate governance mechanism, namely: SSB (Farook & Lanis, 2005; Haniffa & Cooke, 2002; Ho & Wong, 2001).

The audit committee plays an important role in supervising both quality of the audit and financial reporting (Davidson *et al.*, 2005; Walker, 2004). Forker (1992) argued that the presence of an audit committee may improve the internal governance, and it acts as an effective supervision mechanism for improving the quality of disclosure. Recently, the literature showed that the environment of corporate governance has importantly improved with the use of audit committees and external audit (Cohen & Wright, 2009). A study of O'Sullivan *et al*. (2008) found that the audit quality is an important determinant that influences the disclosure level. On the other hand, external auditors must be free from any control in instilling confidence in investors and other stakeholders in the audited financial statements. According to Manspouri, Pirayesh and Salehi (2009), the external audit function is based on the standards of the accounting profession that are in line with the quality of audit services. There is evidence that the audit quality has the positive correlation with audit independence (Mansouri *et al*., 2009).

In the case of Islamic financial institutions, an audit committee should include non-executive directors, most of whom are independent, including the chairman of an audit committee. Furthermore, members of an audit committee must have experience and skills in the banking industry. In addition, Islamic banks should have a policy on how to select external auditors based on the recommendation of an audit committee.

According to Ho and Wong (2001), the influence of internal governance indicators on company's disclosure refers to two perspectives, complementary and substitutive. The complementary viewpoint is described as that "more governance mechanisms will strengthen the internal control of companies and provide an intensive monitoring package for a firm to reduce opportunistic behaviour and information asymmetry" (Ho & Wong, 2001, p. 143), which leads to a higher level of disclosures, while the substitutive perspective explains that more governance mechanisms may lead to a lesser extent of disclosures. If information asymmetry within a corporation can be reduced because of existing monitoring packages such as the board of directors to improve the level of disclosure, the need for installing further monitoring is lower (Ho & Wong, 2001). Based on the fact the conflict of these two perspectives on the corporate governance influence has not been completely resolved, Hill (1999 cited in Ho & Wong, 2001, p. 143) stated that: "no single governance mechanism is a panacea and suggests that it is desirable to have a system of overlapping checks and balances".

In the context of Islamic banks, the influence of internal governance on CSR disclosure is based not only on the mechanisms of the board of directors and audit committee, but also on SSB. It is expected that the existence of a board of directors, audit committee, and SSB together within an Islamic bank may lead to higher CSR disclosure levels. Alternatively, even as the existence of board of directors, audit committee and SSB may guide the organization to higher levels of monitoring, and in so doing, improved disclosure information of CSR, the extent to which these corporate mechanisms would affect disclosures of CSR may also rely on their characteristics (Farook & Lanis, 2005; Haniffa & Cooke, 2002; Ho & Wong, 2001). Therefore, a huge number of determinants that relate to the board of directors' structure, audit committee attributes, and external audit and SSB's characteristics may determine the level of CSR information disclosed by Islamic banks.

Based on the above discussion, strong corporate governance may lead to increase CSR disclosure of information published in the annual reports, and this is supported by previous studies that found links between good corporate governance practices with more disclosure practices (Beekes & Brown, 2006). The study divides the singular corporate governance mechanisms into three groups: board of directors' effectiveness, *Shariah* supervisory board (SSB) and audit quality. Then, these groups are combined into a summary measure of the governance variables. The researcher believes these measures of governance factors are strong proxies for determining the condition of a firm's corporate governance standards quality.

3.3.2.1 Board of Directors' Effectiveness (BODE)

Board of directors' effectiveness in the current study includes three corporate governance characteristics, consisting of board composition, the separation of CEO and chairman's role, and the chairman's position.

3.3.2.1.1 Board Composition–Proportion of Non-Executive Directors

There are many theories that have been developed to describe the BoD's role, such as agency theory, stakeholder theory and legitimacy theory. These theories give an inclusive explanation of the independence of the board. The role of the BoD is in controlling and monitoring the situation to making decisions, focusing on the degree of strategic processes, and ensuring that management behavior is consistent with the stakeholders’ interests. In other words, the board of directors to hire the CEO to manage and oversee the day-to-day activities of the company, and the CEO has the responsibility to execute the corporate policy (Weir & Laing, 2001).

According to Pound (1995), the major role of the directors on the board is to manage the functions of a company. The directors on the board are an internal monitoring mechanism intended to take the right decisions on behalf of the shareholders to ensure that management is in place and to maximize the shareholders’ wealth. From an Islamic perspective, the members of the board of directors must have the reputation of moral integrity and technically qualified in the banking business to play their role effectively. They must have also additional abilities to enable them to understand and be aware of the *Shariah* principles and rules, and the Islamic teachings related to business and finance.

There are many functions for the board of directors in exercising full effective control over the transactions of the bank. One of the board’s crucial roles is to specify clearly the policy objectives and guiding the bank principles, codes of conduct for senior management, and requirements of proper behaviour for the staff (Chapra & Ahmed, 2002). Therefore, the board is to be able to carry out this function successfully when corporations have strong internal control systems, proper accounting procedures, efficient risk management, effective internal and external auditing, and all necessary checks and balances, including rules, regulations, and procedures. The board should also ensure that all appointments, especially for the position of CEO, are made according to merit without any preference and/or nepotism. For more effective monitoring and control of the management, non-executive directors have to be independent of the executive management (Gubitta & Gianecchini, 2002), and free from any dealings or other relationships with the company that could compromise their autonomy. Non-executive directors can play this critical role by monitoring the manager's opportunistic and preferential actions (Fama & Jensen, 1983; Leftwich, Watts, & Zimmerman, 1981; Leung & Horwitz, 2004).

Haniffa and Cooke (2005) asserted that corporate social disclosure practices can be viewed as a policy that is intended to close the legitimacy gap perceived between management and shareholders through the non-executive directors. In addition, non-executive directors are expected to respond to concerns about the reputation and duties, and would generally be more interested in fulfilling the social responsibilities of a company (Zahra & Stanton, 1988) that may support their status and reputation in the community. Therefore, non-executive directors may be able to put pressure on the firms to provide CSR information in their annual reports.

Previous studies found that the board composition of a corporation is an important determinant affect the voluntary disclosure in the annual reports (Barako *et al.*, 2006; Eng & Make, 2003; Gul & Leung, 2004; Haniffa & Cooke, 2005; Huafang & Jianguo, 2007; Li *et al.*, 2008; Patelli & Prencipe, 2007).

Chapra and Ahmed (2002), Fama and Jensen (1983), and Leftwich *et al.* (1981) argued that the strength of the non-executive directors in the board of directors depends on the independence of the management. Based on agency theory, the board of directors that has more members who are non-executive directors is likely to be more effective in monitoring the managerial opportunism (Cotter & Silvester, 2003; Ho & Wong, 2001), and companies may tend to provide more voluntary disclosure (Eng & Mak, 2003). Besides, the resource dependence theory suggests that the existence of the non-executive directors on the board provides a link between the corporations and the external environment because of their knowledge, reputation, and dealings (Haniffa & Cooke, 2005).

The other view against the dominated by non-executive directors contains strangling strategic procedures where executive directors concentrate on corporate acquisition strategy for achieving great amount of money from the attempted hostile seizure of bigger undervalued or inefficient firms (Goodstein *et al*., 1994), extreme controlling, as executives directors manage and organize daily transactions, and could not fulfil the monitoring effectively (Baysinger & Butler, 1985), lack of business wisdom to be effective, as executives are less interacting with external environment to extract important resources (Patton & Baker, 1987), and lack of actual independence, as an executive director would be under the dual leadership structure, and would unable to put away its interest as a manager of the company when serving as a director (Demb & Neubauer, 1992).

In terms of CSR disclosure, composition of the board of directors might be an important mechanism to consider because that the existence of non-executive directors on the board will give more power to compel management to provide disclosure. Previous studies on voluntary disclosure found inconsistent findings. Results by Akhtaruddin *et al.* (2009), Barako and Brown (2008), Chen and Jaggi (2000), Khan (2010), Li *et al*. (2008) and Rashid and Lodh (2008) revealed a positive significant relationship between the composition of board and disclosure. In contrast, Barako *et al*. (2006), Gul and Leung (2004) and Haniffa and Cooke (2005) indicated a negative significant association. Other studies found an insignificant association (Eng & Mak, 2003; Ho & Wong, 2001; Huafang & Jianguo, 2007; Said *et al*., 2009). In the case of Islamic banks, the above discussion regarding the effectiveness of the monitoring function of non-executive directors the study expects that the high percentage of non-executive directors on the board lead to disclosing more CSR information.

3.3.2.1.2 The Separation of the Chairman and CEO Role

Another aspect to examine the independence of the board is the “dominant personality” phenomenon (Chapra & Ahmed, 2002; Forker, 1992; Ho & Wang, 2001). The issue refers to role duality, in which both the functions of chief executive officer and chairman controlled by one person. Segregation of the two functions gives the necessary checks and balances of power and authority on management behaviour (Blackburn, 1994; Chapra & Ahmed, 2002). From an Islamic perspective, there is an obvious separation of accountabilities at the top management of an Islamic bank through the separation between the CEO and Chairman, who performs two distinct functions. This will lead to one of the most important constraints on the management of Islamic banks, which is that key decisions made should not be done by one person (Chapra & Ahmed, 2002).

According to Chapra and Ahmed (2002), the management will be able to achieve its effective role completely when it has all the three essential virtues (honesty, frugality, and preparedness), in which Qur'an and the *Sunnah* are full of statements to this effect.

In contrast, the presence of role duality facilitates the CEO managing the functions of the board such as meetings, agenda discussion, and choosing the board's members (Al-Arussi *et al*., 2009). Role duality also allows the CEO to regulate the company in achieving its goals and improves the leadership in a firm (Dahya *et al.*, 1996). From stewardship theory, there is no problem if the two functions are combined.

Forker (1992) showed that CEO duality is correlated with lesser voluntary disclosure levels, and separating the roles of CEO and chairman could help enhance monitoring quality and improve the disclosure quality. Consistent with this result, Gul and Leung (2004) and Huafang and Jianguo (2007) found a negative significant relationship between duality and the level of disclosure. Their findings are also supported by Al-Arusi *et al*. (2009), who found the correlation between the separation of the chairman and CEO's function and voluntary financial and environmental disclosure by Malaysian firms. On the other hand, Barako *et al*. (2006), Eng and Mak (2003), Ho and Wong (2001), Li *et al.* (2008) and Said *et al*. (2009) found an insignificant relationship between duality and disclosure.

In the context of Islamic banks, role duality is not primarily common within the banks, but the possible effect on disclosure is considered to be an important factor.

This is due to the fact that numerous firms have a combined role of the chairman and CEO on their boards, and they are working successfully, as well as having the capacity to keep the top management in check (Eisenhardt, 1989; Haniffa & Cooke, 2002).

Hence, based on empirical previous studies about role duality, this study expects a positive association between the separation of the Chairman and CEO's function and CSR information disclosed by Islamic banks.

3.3.2.1.3 Chairman's Position

The chairman's independence is an important element in enhancing board efficiency (Haniffa & Cooke, 2002). There is evidence that chairman's independence improves corporate governance (Donaldson & Davis, 1991; Rechner & Dalton, 1991) and enhances corporate governance quality (Coulton, James, & Taylor, 2003). The independence of the chairman also enhances the quality of monitoring and reduces the information asymmetry, thus improving the reporting quality (Forker, 1992). From an Islamic perspective, Islamic banks should have clear separation of duties at the top management of a bank to certify independence and stability of power and authority between the CEO and Chairman, since they perform two distinct functions in an Islamic bank (Chapra & Ahmed, 2002).

Haniffa and Cooke (2002) found that the independence of the chairman has a significant negative relationship with the level of voluntary disclosure. This finding is inconsistent with the agency theory, which documents that the chairman as non-executive director in the firm can play a greater independent function in improving the disclosure because of accountabilities at the top of the firm and influential power. Therefore, it is expected that the existence of an independent chairman will increase CSR disclosure.

Board autonomy as the independent variable composes the basis of the first hypothesis. Previous studies that investigated the board of directors found a positive correlation between watchfulness of the board and the disclosure level of a firm (O'Sullivan *et al.*, 2008). Therefore, it is expected that the greater the autonomy of the board the more CSR disclosure will be provided. This discussion can lead to the following alternative hypotheses:

H_2: There is a positive relationship between the percentage of non-executive directors on the board of directors and the disclosure level of CSR in annual reports of Islamic banks.

H_3: There is a positive relationship between the separation of CEO and Chairperson's role and the disclosure level of CSR in annual reports of Islamic banks.

H_4: There is a positive relationship between a non-executive chairman and the disclosure level of CSR in annual reports of Islamic banks.

3.3.2.2 The Effectiveness of the *Shariah* Supervisory Board (ESSB)

Islamic banks work under a diverse construction of corporate governance than the one employed in the conventional banking, which is considered as a special type of supervision to reduce the difference of interest between the investors and the management of a bank. According to AAOIFI standards, the *Shariah* supervisory board (SSB) role is trusted with the directing duty; revision and monitoring the transactions of banks one by one to make sure those transactions conform with rules and principles of *the Shariah.* The SSB is chosen by the general assembly of shareholders, and recommended by the meeting of the board of directors for the SSB. This board is not only independent of the board of directors, but is also permitted to be present at the board of directors' gatherings to argue the religious sides of their decisions (AAOIFI, 2005).

The main objectives of the SSB are guiding the Islamic banks to set the policies and regulations based on the *Shariah* principles and rules; approving financial dealings from the legal view, and in making ready agreements of the bank for future dealings that comply with the *Shariah* teachings of (Daoud, 1996). The authority of the SSB is derived from the *Shariah* rules and principles, other than what the board of directors has in conventional banking industry. Islamic banks delegate the SSB in the general meeting to clarifying any *Shariah* issues regarding the financial transactions those stakeholders might have. The SSB also gives advice to the board of directors and the top management related to the *Shariah* issues, and conducts confirmations of the internal auditing regularly based on the banks' deeds to ensure their compliance with the Islamic rules and principles in all activities (AAOIFI, 2005).

The SSB plays the same function of the board of directors except the setting of plans and strategies, because the main duty of SSB is reviewing the current and historical occurrences rather than setting up future strategies (AAOIFI, 2005). Grais and Pellegrini (2006a) asserted that the SSB has five diverse duties. First, giving fatwas about financial instruments used. Second, checking that the operations conform to issued fatwas. Third, computation of the amount of *Zakah* paid. Fourth, disposing of the revenues or expenses, those are non-*Shariah* compliant. Last, advising shareholders and investment account holders how to distribute their earnings or expenses. The SSB has to review all contracts, agreements, financial products and activities, and ensure their conformity with the Islamic rules and principles. The SSB also has to assess further information and reports such as circulars, operating and financial reports, and policies. This authority of SSB is equal to those of external auditors (Karim, 1995). In addition, SSB has the right to employ a *Shariah* internal auditor to supervise the daily dealings, and to report directly to them about any transactions that do not comply with the *Shariah* rules and principles (Al-Mahmoud, 2007). The responsibility of management is to provide the SSB with all information linked to the Islamic banks' transactions and products' compliance with the *Shariah* rules and principles. The SSB can release the management from any responsibility for the Islamic banks' transactions when it accesses all resources of information. The SSB members act as advisers and counselors for the stakeholders, regulators, central banks and the Muslim community at large. The board should also respond to all the enquiries of investors and explain any uncertainty in any dealings. The major values that are brought by the SSB to the Islamic banks are the transparency, moral behavior, and credibility, as well as trust for all the stakeholders, such as employees, creditors and customers, not just for the shareholders.

If the SSB members ensure that all transactions of the Islamic banks are compliant with the *Shariah* rulings, they may play a function in mandating action and disclosure of CSR. On the other hand, the influence of SSB on the disclosure of CSR is based on the role of SSB in supervising on behalf of equity holders as well as investors.

There is evidence that Islamic banks do not need more monitoring on CSR disclosure from the SSB members if activities of the bank are compliant with the *Shariah* rulings. The SSB members should ensure all stakeholders of the Islamic banks (shareholders, management, employees, suppliers, depositors and community) are more confident in their report about CSR activities (Farook & Lanis, 2005; Haniffa & Hudaib, 2007; Maali *et al*., 2006). Given that Farook and Lanis (2005) stated that the existence of SSB monitoring can reduce information asymmetry, then the need for setting up more control through larger amounts of CSR disclosure information to ensure all stakeholders of the bank's commitment to *Shariah* rulings is lower.

From an Islamic viewpoint, the nature of compliance with *Shariah* rules and principles is required, not only ensuring that all transactions and activities of the banks are consistent with the *Shariah* report, but also for greater contribution in CSR activities in the society. This rationale is aligned with the function of the SSB, as stated by AAOIFI. It can be argued that the existence of the SSB in an Islamic bank may improve the monitoring, and thereby lead to more information related to CSR (Farook & Lanis, 2005). The extent to which the SSB affects the disclosure level of CSR may also be based on the corporate governance mechanisms. Hence, a number of determinants that are associated with SSB characteristics may affect the effectiveness of the SSB's role, and consequently, the extent of CSR disclosure among Islamic banks, such as size, independence, education and experience, directorship, and the lack of disclosure information (Haniffa & Cooke, 2005; Grais & Pellegrini 2006a; Nathan & Pierce, 2009). The current study examines four attributes of the SSB, namely: number of board members, cross membership, secular educational qualifications, and reputability.

3.3.2.2.1 Number of SSB Members

Empirical evidence in corporate governance suggests that the board's size impacts the level of controlling, monitoring, and disclosure (Akhatruddin *et al.*, 2009; Chaganti, Mahajan, & Sharma, 1985). While there is no restriction on the number of the SSB members, debatably the perfect number comprises between three to seven members. The common number of SSB members in an Islamic bank is three members, which is consistent with the AAOIFI standards. The greater number of members in a SSB tends to lead to more effective monitoring, and more consistency with rules and principles of *Shariah*. The large number of members of the SSB will be in further controlling and supervising the banks' transactions to ensure their conformity with the *Shariah* rulings. This type could provide more transparency, moral behaviour, respect for stakeholder groups, and maximization of CSR disclosure. According to Chen and Jaggi (2000), the larger size of the board may decrease the possibility of information asymmetry. Moreover, the higher the members of the board is the less uncertainty and lack of information (Birnbaum, 1984). The SSB members should be ideally knowledgeable in the Islamic law and economics, rather than those who specialize in the business and accounting practices (*fiqh* almua'malat) (AAOIFI, 2005). The combination of *Shariah* and financial skills for SSB members lead to the derivation of better applications of *Shariah* rulings, particularly regarding transparency and disclosure. This leads the implementation of diverse viewpoints on *Shariah* enforcement by extending the SSB to present these sectional professions.

The board's size is expected to affect the ability of the board to monitor and review all transactions of the Islamic banks to ensure their operations are in conformity with *Shariah* rules and principles. In addition, the ability of members of the SSB to monitor the bank's activities that would affect the well-being of the society is much higher with the greater number of members on board. With more members, the collective knowledge and experience of the SSB will increase, and consequently, leading to greater disclosure of CSR information.

3.3.2.2.2 Cross Memberships of SSB

Cross membership is another important aspect of SSB members, which determines the CSR disclosure of Islamic banks (Farook & Lanis, 2005). There is evidence that cross-directorship makes information more transparent through comparing the knowledge that is gained from other companies on one hand (Dahya *et al.*, 1996); and decisions taken at one board may become part of the information for decisions at the other boards, on the other hand (Haat, Abdul Rahman, & Mahenthiran, 2008; Haniffa & Cooke, 2002). The cross-memberships act as a channel of information for business practices (Useem, 1984). Furthermore, the cross-memberships of SSB are preferable because of their knowledge and credibility (Lorsch & MacIver, 1989). In addition, the members of the SSB with cross membership will enable them to share their tacit and explicit knowledge in implementing the *Shariah* rulings in Islamic banking. By increasing the number of SSB members, it will lead to improving their knowledge about the enforcement of the *Shariah* principles to corporate reporting, particularly to the disclosure level of CSR.

3.3.2.2.3 Secular Educational Qualifications

Educational background is a significant factor of disclosure practice (Haniffa & Cooke, 2002; Farook & Lanis, 2005). The director with more education is expected to accept new actions and embrace uncertainty (Hambrick & Mason, 1984). Education can act as an important institutional asset that could affect the accounting values and practices (Gary, 1988). Further, education can be used as a sole measure for determining the professional level (Grace, Ireland, & Dunstan, 1995). Wallace and Cooke (1990) stated that "an increase in the level of education in a country may increase political awareness and demand for corporate accountability" (p. 84).

Prior studies indicate that the education level of SSB members increases the disclosure level related to CSR information by Islamic banks (Farook & Lanis, 2005). Regarding the unique role that SSB members are called upon to fulfil, SSB members should have knowledge ideally in Islamic law, economics, and financial and accounting practices, which enables them to know not only the *Shariah* problems but also problems relating to law and economics, since such problems in many situations are inter-penetrating. Usually, the members of SSB include religious scholars who have higher education in Islamic law rather than in secular studies. The SSB members who have little knowledge of modern banking, he or she may be unable to apply fully the theories of *Shariah* rules and principles for the very complex financial products and transactions. According to Farook and Lanis (2005), members of the SSB who have a doctoral degree are debatably better well-versed in the present implications of Islam for the banks, especially regarding disclosure of CSR.

3.3.2.2.4 Reputable SSB Members

The SSB has been composed of *Shariah* scholars who had a larger amount of explicit knowledge in Islamic commercial law to apply the *Shariah* rules and principles, and who, therefore, have little qualifications from secular educational institutions, as well as those who often cannot understand the language in which transactions are conducted. The determinants affecting the directors' appointments in Bahraini firms are pertinent skills, business practices and reputation (Hussain & Mallin, 2003). As mentioned earlier, the role of both board of directors and SSB is quite similar, and it is expected that the factors that influence the board of directors will affect the SSB as well. However, *Shariah* scholars have an excellent reputation in their community because of their universal knowledge of Islam and their significant function in that community. In other words, they are scholars whom their community has agreed and identified those scholars as reputable. For this reason, their reputation is a measurement for their business knowledge, and therefore, scholars who have a good reputation are more possible in comprehending the modern applications of banking industry regarding disclosure. The results of Farook and Lanis's study in 2005 indicated that reputation is instrumental in measuring the disclosure level of CSR among Islamic banks. Therefore, reputable scholars are more expected to propose that Islamic banks provide more information regarding CSR.

Prior studies found a positive significant association between the existence of SSB and its characteristics and the disclosure level of CSR by Islamic banks (Farook and Lanis, 2005). This result will lead to the second alternative hypotheses of corporate governance:

H_5: There is a positive association between the existence of the SSB and the disclosure level of CSR in the annual reports of Islamic banks.

H_6: There is a positive association between the size of SSB and the level of CSR disclosure in the annual reports of Islamic banks.

H_7: There is a positive association between the percentage of SSB members with cross memberships and the disclosure level of CSR in the annual reports of Islamic banks.

H_8: There is a positive relationship between the percentage of the SSB members with doctoral qualifications and the disclosure level of CSR in the annual reports of Islamic banks.

H_9: There is a positive relationship between reputable scholars of the SSB and the level of CSR disclosure in the annual reports of Islamic banks.

3.3.2.3 Audit Quality

In general, auditing decreases information asymmetries that exist between the managers and stakeholders. Audit quality can be defined as the probability of an auditor discovering and disclosing an error in the accounting system of an organization (DeAngelo, 1981). The two primary factors that affect both internal and external audit quality are the auditor expertise through gaining education and training, and practical experience from auditing a specific sector (Gramling & Stone, 2001), as well as the code of ethics that refers to the independence from management. The audit effectiveness and its ability to constrain the earnings management are based on the audit quality, which detects questionable accounting practice. In recent years, auditors indicated that the corporate governance environment has significantly improved with the use of audit committees and external auditors (Cohen & Wright, 2009). In addition, a positive relationship exists between audit quality and the disclosure level of forward-looking information in the financial reports (O'Sullivan *et al*., 2008).

There are different proxies that have been used by prior studies to measure audit quality. Most researchers used the size of the audit firms to measure audit quality (Francis & Wilson, 1988; Mansi, Maxwell, & Miller, 2004; Palmrose, 1986; Simunic & Stein, 1987) or auditors' investment in firm reputation (Beatty, 1989; Becker, DeFond, Jiambalvo, & Subramanyam, 1998; Mansouri *et al*., 2009). The minority used premium fees (Copley, 1991; Craswell, Francis, & Taylor, 1995), or extent of litigation (Palmrose, 1988; St. Pierre & Anderson, 1984). However, the effectiveness of audit quality may depend on greater monitoring and thus higher CSR disclosure information, and it also depends on the attributes of the corporate mechanism (Haniffa & Cooke, 2002; Ho & Wong, 2001). Hence, a large number of determinants that relate to the audit quality attributes may affect the disclosure level of CSR among Islamic banks.

This study uses certain audit attributes related to audit quality, comprising the existence and composition of an audit committee, the frequency of audit committee meetings, and the expertise of audit committee members. This is because the main function of an audit committee is monitoring both the audit quality and financial reporting quality (Davidson *et al*., 2005; Walker, 2004). In addition, the efficiency of the external auditor may also improve the audit quality based on the size of the audit company.

3.3.2.3.1 The Existence of an Audit Committee

The audit committee plays an important role through reviewing the internal and external auditor reporting, and to assist the flow of information across the board of directors, which reduces the conflicts between the management and auditors (Cohen *et al*., 2002; Gibbins, Salterio, & Webb, 2001; McMullen & Raghundan, 1996). In the case of Islamic banks, the main function of an audit committee is to achieve the essential objectives of the bank by improving corporate transparency and disclosure in the annual reports, and enhancing the confidence of public in Islamic banks by ensuring that all their transactions are in compliance with *Shariah* principles.

Previous studies indicated that the existence of the audit committee significantly influences the corporate disclosure level (Barako *et al*., 2006; Ho & Wong, 2001; Said *et al*., 2009). The essential role of the audit committee is to ensure the financial accounting and control system works well (Collier, 1993). Audit committees act as monitoring mechanisms and its presence enhances the reliability of external financial reporting (Bradbury, 1990; Mc Mullen & Raghunandan, 1996). To improve the extent of relevance and reliability of the annual report, the board of directors usually delegate accountability for supervising the financial reporting to the audit committee (Davidson *et al*., 2005; DeZoort, 1997; Wolnizer, 1995). According to AAOIFI (2005), the major functions of an audit committee for Islamic financial institutions are: Firstly, the audit committee preserves the integrity of the annual report process by reviewing all transactions of an organization, and ensuring that the annual report is complete, fair and accurate. Secondly, the committee protects the different groups of shareholders, investors, and other stakeholders. Thirdly, to enhance the assurance of reliability of information in the annual report before to pass it to the board of directors. Therefore, the audit committee acts as an effective monitoring mechanism to enhance the quality of disclosure, as well as reduce the agency cost (Forker, 1992). It is expected that the presence of an audit committee improves the quality of information disclosure in the annual reports. This discussion leads to a positive association being expected between the existence of the audit committee and the disclosure level of CSR in annual reports.

3.3.2.3.2 The Size of an Audit Committee Board

The size of the audit committee commonly has been seen to have a major influence on its effectiveness (Cadbury Committee, 1992). Each audit committee has at least three directors, which was suggested in several guidelines for corporate governance (ASX, 2007; IFSB, 2006; KLSE, 2011). According to Kalbers and Fogarty (1993) and (Braiotta, 2000), the bigger committee has larger power and organizational position, and the basis of extensive knowledge and skills (Karamanou & Vafeas, 2005). Therefore, the audit committee requires sufficient members, but not too large, to perform its obligations effectively to reduce process losses (Karamanou & Vafeas, 2005). Previous studies indicated that firms with smaller audit committees tended to make more earnings forecasts than those with bigger committees (Karamanou & Vafeas, 2005). This result is supported by Akhtaruddin *et al*. (2009), who found a negative association between the size of audit committees and voluntary disclosures. On the other hand, Mohd-Saleh *et al*. (2007) found no relationship between the size of the audit committees and earnings management, while Dalton *et al.* (1999) indicated a positive association with greater performance, and this result is in line with resource independent theory. In the case of Islamic banks, the audit committee that has more members is expected to enhance the quality of CSR reporting.

3.3.2.3.3 Expertise of Audit Committee Members

Members of an audit committee should possess the necessary expertise that enables them to fulfil their accountabilities for supervising the internal control and financial reporting. According to section 407 of the Sarbanes-Oxley Act of 2002 (SOX) in the US and the Listing Requirement of Bursa Malaysia, it requires that at least one of the audit committee members has finance or accounting expertise.

McDaniel, Martin and Maines (2002) documented the information that an audit committee that includes financial experts is more likely to improve financial reporting quality, and therefore, decrease financial problems in companies (McMullen & Raghunanthan, 1996). Previous empirical studies examined the influence of financial expertise of an audit committee on the quality of financial reporting, and the findings were mixed. Abbott, Parker and Peters (2004) found a significant negative relationship between financial expertise and the restatement. This result is in line with Bédard, Chtourou and Courteau (2004), who also found that the financial and governance expertise of audit committee members has a negative influence on the aggressive earnings management. On the other hand, Cohen and Wright (2009) found that the experiences of audit committee members have a strong, positive influence on financial reporting quality. However, Mohd-Saleh *et al.* (2007) found that companies that had audit committee members that were more knowledgeable in accounting recorded fewer earnings management practices compared to other firms. In addition, audit committee members with financial knowledge can perform their responsibilities more effectively than members without such knowledge. Moreover, companies with financially knowledgeable members in their audit committees are expected to provide more information about CSR in the annual report of Islamic banks.

3.3.2.3.4 Composition of an Audit Committee Board

Wright (1996) found that composition of an audit committee is powerfully correlated with financial reporting. The composition of an audit committee refers to the independence, which is important for a board committee to be effective in their monitoring (AAOIFI, 2005; Davidson *et al*., 2005; Klein, 1998).

The audit committees' composition, with both insiders and outsiders' members, is also a significant variable in explaining the extent of disclosure. The audit committee members' independence and their qualifications are the main determinants in performing their oversight functions. Audit committees are unable to conduct their responsibilities effectively when members are also executive directors of the company (Lynn, 1996). According to Menon and Williams (1994), the audit committees should include wholly non-executive or independent directors, who are better monitors of management than are inside directors (AAOIFI, 2005; DeFond & Francis, 2006). This is supported by the Cadbury Report (1992), which stresses the significance of having at least three non-executive members on the board of an audit committee. This is also consistent with Bursa Malaysia, which necessitates at least three directors, the majority of whom are independent of management, and at least one of the audit committee's members to have financial knowledge. In addition, the audit committee of an Islamic bank shall not have less than three members, and they should have sufficient knowledge about business and applicable laws, as well as understand the related rules and principles of *Shariah* that enable them to deal adequately with the accounting and auditing issues that they face (AAOIFI, 2005). However, empirical studies on supervision motivations of the audit committee suggest that there is an association between the independence of audit committee members and the level of disclosure. Klein (2002) and Mohd-Saleh *et al.* (2007) explain that the independence of audit committees reduces the possibility of earnings management; therefore, it improves the voluntary disclosure. A study by Said *et al*. (2009) found a positive and significant relationship between the percentages of independent non-executive directors sitting on the audit committee and the level of CSR disclosure in Malaysian public listed firms. The independence of an audit committee is expected to enhance corporate disclosure and transparency. Hence, based on the above discussions, the independence of audit committee members is more possible to associate with the level of CSR disclosure within Islamic banks.

3.3.2.3.5 The Frequency of Audit Committee Meetings

According to Kelton and Yang (2008), the frequency of audit committee meeting is generally employed as a measure for the diligence of an audit committee. Audit committees are required to be functional (Collier, 1993; Hughes, 1999), and to perform their responsibilities effectively. The number of committee meetings included through the financial year reflects the extent of audit committee activity that has been operationalized (Chtourou, Bédard, & Courteau, 2001; Xie, Davidson III & DaDalt, 2001). Earlier studies on the frequency of audit committee meetings show that companies whose audit committees meet at least four times yearly are seldom expected to have repeated audited financial statements (Abbott, Parker, Peters, & Raghunandan, 2003). In addition, Bronson, Carcello and Raghunandan (2006) found that the number of audit committee meetings has a positive impact related to disclosure level of management reports on internal controls. This result is supported by Kelton and Yang (2008) and Li *et al*. (2008), who found that companies with more diligent audit committees (determined by the number of meetings) are more expected to provide Internet financial and intellectual disclosures, respectively. From these results, it is expected that the Islamic banks with a higher frequency of audit committee meetings are expected to disclose more information about CSR.

3.3.2.3.6 Audit Firm Size

Audit companies are primarily split into large (big) companies and small (not big) ones. Larger audit companies are widely spread throughout the world while smaller audit companies operate their activities domestically. In recent years, expansion of accounting and auditing services and products requires a minimum level of education, which caused a higher quality of audit practice. Previous studies found that the larger audit companies are given higher audit quality (Ashbaugh & Warfield, 2003; Leuz & Verrecchia, 2000; Lowensohn, Johnson, Elder, & Davies, 2007). This finding is because the theory suggested that the audit company's size was a measure for audit quality and of better monitoring ability (DeAngelo, 1981). A related line of research argues that bigger international auditing companies have built reputations of the brand-name, and then providing high-quality audits in order to preserve their reputation (Francis & Wilson, 1988; Palmrose, 1986; Simunic & Stein, 1987). Large audit firms also have more resources, higher-quality staff, and are more independent (Chan, Ezzamel, & Gwilliam, 1993; DeAngelo, 1981; Mansouri *et al*., 2009; Palmrose, 1986). In addition, previous studies suggested that the audit firm size is a critical determinant that affects the extent of voluntary disclosure (Ahmed, 1996; Akhtaruddin *et al*., 2009; Craswell & Taylor, 1992). Therefore, large audit companies are more expected to make higher CSR disclosure in corporate annual reports.

Hence, audit quality composes the third independent variable, and leads to the basis for the following alternative hypotheses:

H_{10}: The existence of an audit committee is related to the disclosure level of CSR in annual reports of Islamic banks.

H_{11}: An audit committee that has a greater number of members is expected to provide more information about CSR.

H_{12}: There is a positive relationship between the audit committee that has at least one member with finance or accounting qualification and the disclosure level of CSR in the annual reports of Islamic banks.

H_{13}: There is a positive association between the percentage of non-executive directors on the board of an audit committee and the level of CSR disclosure in the annual reports of Islamic banks.

H_{14}: There is a positive relationship between the number of audit committee meetings yearly and the disclosure level of CSR in the annual reports of Islamic banks.

H_{15}: There is a positive association between audit company size and the disclosure level of CSR in the annual reports of Islamic banks.

3.3.2.4 Corporate Governance Score

This research also investigates the merger of all corporate governance groups within the Islamic banks on the level of CSR disclosure. This study deviates from previous studies in at least one of three ways. First, many previous empirical studies have focused on the influence of only one or two corporate governance attributes. On the other hand, this study considers a broad set of governance attributes, similar to the approach of O'Sullivan *et al*. (2008). Second, this study, to my best knowledge, is the most comprehensive to date in terms of sample size and breadth of coverage. Furthermore, previous studies have been characteristically limited to large firms (O'Sullivan *et al*., 2008), or have investigated just one or two mechanisms of corporate governance. Third, this study combines the individual governance attributes within each of the three independent variables by allocating an overall governance score for each bank. By doing so, Islamic banks may prefer to choose from a group of corporate governance attributes. Nevertheless, strong overall corporate governance should be a guide to improve transparency of the annual reports, thereby leading to more disclosure of the CSR information. Therefore, an Islamic bank's overall governance score leads to the following alternative hypothesis:

H_{16}: There is a positive relationship between the overall score of an Islamic bank's corporate governance structure and the disclosure level of CSR in the annual reports.

3.3.3 Firm Characteristics as Control Variables

Previous studies have been indicated that activities of CSR disclosure vary through countries, firms, industries, and time (Gray *et al*., 1995a, 1995b; Hackston & Milne, 1996). This action of CSR disclosure has been significantly measured by diverse company and industry characteristics. The importance of CSR disclosure in Islam is demonstrated by a company's accountability to its community (Haniffa, 2001). In addition, CSR disclosure of an Islamic bank plays a primary role in improving transparency of business activities through fulfilling the spiritual needs of the Muslim population. The theories that appear to have been most prosperous in explaining the nature and level of CSR disclosure are the stakeholder and legitimacy theories (Gray *et al*., 1995a; Milne, 2002). CSR disclosure based on both theories has been used to protect the company's reputation and its identity (Hooghiemstra, 2000). Hence, this study employed the firm attributes of size and financial performance as control variables.

3.3.3.1 Size of the Bank

Larger companies likely have more business activities that may affect society. For that reason, bigger corporations are expected to voluntarily provide more information to reduce potential conflicts between the management and stakeholders (Inchausti, 1997). Watts and Zimmerman (1986) argued that the large firms are more exposed to community scrutiny than smaller ones. At the same time, larger companies can get innovative funds at lesser cost through disclosing more information (Botosan, 1997). Large firms that have a great influence on society may have larger groups of stakeholders such as the public, consumers and employees, which affect the companies (Hackston & Milne, 1996). Further disclosure can help reduce potential agency costs, because agency costs are higher for bigger companies (Watts & Zimmerman, 1986). In addition, big companies are seen more politically, and thus, disclosing more information. The legitimacy theory hypothesizes that there is a relationship between a company size and its CSR disclosure (Hackston & Milne, 1996; Hamid, 2004; Naser *et al*., 2006). According to legitimacy theory, sizeable firms tend to disclose more information about CSR in their annual reports, which generally reflects their responsibilities towards society, and to meet public pressure. From an Islamic perspective, based on social accountability and full disclosure, large companies would likely become more concerned with society and consequently, would provide more information related to CSR in the annual reports to release their accountability to stakeholders, particularly Muslim stakeholders (Haniffa, 2002; Othman *et al*., 2009). In the case of Islamic banks, there is evidence that banks in rich countries are larger in size, which is then expected to support economies of scale, decrease the collection costs and processing information (Boyd & Runkle, 1993), as well as allowing Islamic banks to offer a longer list of options for financial services (Bashir, 1999). Therefore, large financial organizations have more resources in terms of financing, facilities, and human resources, and would expected provide more information regarding CSR disclosure. Empirical evidence found a positive relationship between voluntary disclosure and company size (Kent & Ung, 2003) in both types of disclosure; quality and quantity (Coulton *et al.*, 2003; Lang & Lundholm, 1993). Relative to the CSR disclosure, previous studies indicated that there is a positive association that exists between the disclosure level of CSR and company size (Cowen *et al.*, 1987; Hackston & Milne, 1996; Hamid, 2004; Haniffa & Cooke, 2005). In relation to disclosure in Islamic social reporting, particularly, larger companies again are more expected to provide CSR information than smaller ones (Othman *et al*., 2009).

3.3.3.2 Financial performance of the Bank

Prior studies propose that there is a connection between CSR disclosure and company profitability (Gray *et al*., 2001; Hossain *et al*., 2006; Inchausti, 1997; Roberts, 1992; Smith *et al*., 2007). These studies show that a company with higher profitability is more expected to provide more information in contrast to a firm with less profitability. This is aligned with signalling theory, which suggests that firms with the best news are expected to provide more information to investors. From this perspective, the management understands the social responsibility, which is favourable to it as the base of explanations of the good news, and is expected to lead to more social and environmental disclosure in their annual reports. In the same way, the performance evaluation of Islamic banks is an important element to measure the responsible achievement of a bank that aims to realize the financial needs of various stakeholders, which include maximizing the profits, and most importantly, to achieve economic and social welfare, as well as to ensure that all the actions are in conformity with the *Shariah* requirements. Since the *Shariah* rules and principles govern all transactions of Islamic banks, this forces them to disclose more information regarding CSR. Based on the legitimacy theory framework, profitability can be positively or negatively correlated with the disclosure level of CSR (Neu *et al*., 1998). From an Islamic perspective, according to Haniffa (2002), an Islamic bank should be willing to make full disclosure in any case, whether it is achieving profit or loss. The findings from previous studies show that the association between CSR disclosure and financial performance are still inconsistent and mixed. Gray *et al*. (2001), Hackston and Milne (1996), Haniffa and Cooke (2005) Hossain *et al*. (2006), Khan (2010) and Smith *et al*. (2007) found a positive relationship. On the other hand, the studies by Ahmad *et al*. (2003), Belkaoui and Karpik (1989), Branco and Rodrigues (2008b), Cowen *et al*. (1987), Garcia-Ayuso and Larrinaga (2003), and Hamid (2004) indicate an insignificant association between CSR disclosure and financial performance. Regarding Islamic social reporting, profitable firms are expected to disclose more information in their annual reports than lesser profitable firms (Othman *et al*., 2009).

H_{17}: There is a positive relationship between bank size and the disclosure level of CSR in the annual reports of Islamic banks.

H_{18}: there is a positive relationship between bank financial performance and the disclosure level of CSR in the annual reports of Islamic banks.

3.4 SUMMARY

This chapter presents a theoretical framework that explains CSR disclosure. It suggests that, based on legitimacy theory, the socio-political factor (the relevant publics: Proportion of Muslim population) and corporate governance mechanisms determine the disclosure level of CSR by Islamic banks. It also contains the hypotheses development and the research method used in this research to examine the influence of socio-political factor and corporate governance variables on CSR disclosure in the annual reports of Islamic banks by assessing how the banks are more aware of the importance of CSR information. In addition, it explains the population and sampling, as well as the measurement of variables used in this study.

CHAPTER FOUR

RESEARCH METHOD

4.1 INTRODUCTION

The previous chapter presented a theoretical framework which determines the factors that influence corporate social responsibility (CSR) disclosure. The current study employed three models to investigate the framework. The first model is used to measure the influence of socio-political context and corporate governance variables on CSR disclosure separately. The second model is used to examine the impact of the board of directors' effectiveness, the effectiveness of *Shariah* supervisory board (SSB), and the audit quality on CSR disclosure. The third model is used to measure the effect of overall score of corporate governance on CSR disclosure. Bank size and financial performance are employed as control variables for the three models. The CSR disclosure is a cornerstone for this framework.

The primary objective of the present research is to clarify the measurement of CSR disclosure in the annual reports of Islamic banks, using content analysis derived from previous studies. This chapter aims to:

- explain the steps of content analysis of CSR disclosure in the annual reports;
- show the empirical models that are used in the study;
- identify the approach of data collection;
- explain the measurements of CSR disclosure as a dependent variable, and socio-political context as well as corporate governance mechanisms as independent variables.

The next section explains the research design. Section 3 identifies the population and sampling. The last section presents the measurements of both dependent and independent variables.

4.2 RESEARCH DESIGN

Zikmund (2003) highlighted that a research design is considered as a master plan detailing the approach and procedures for collecting and analyzing the required information. A research design mainly is based on the nature of research objectives or research questions. According to Creswell (2004) based on a particular field, researchers carry out studies in order to add to the knowledge. The research design may combine more than one method for the collection and analysis of the data.

4.2.1 Research Method

According to Tejero (2006), research methods are the methods or techniques using for collection and analysis of data. There are two types of methods; quantitative and qualitative, which are knowledgeable. Both methods are employed to describe the phenomenon of corporate social responsibility disclosure. The current study employed the content analysis as a quantitative tool to classify the disclosures into a variety of social responsibility categories as well as the multiple ordinary least square regression (OLS) method, and both techniques selected for this study were the most appropriate to achieve the objective and the problem statement for the study. OLS aims to determine the influence of corporate governance attributes as dependent variables on the disclosure level of CSR derived from the annual reports of Islamic banks around the world.

4.2.1.1 Content Analysis

This study used content analysis technique in order to gather CSR data from annual reports of Islamic banks. This approach has been broadly used in previous studies of social disclosure (Abdul Rahman *et al*., 2010; Gray *et al*., 1995a; Guthrie, Cuganesan, & Ward, 2008; Guthrie & Parker, 1989; Maali *et al*., 2006; Menassa, 2010; Zeghal & Ahmed, 1990). Content analysis is a technique of codifying the content (or text) of a piece of writing into different categories (or themes) responding to chosen standards (Weber, 1988), based on the objectivity. The objectivity of criterion was defined by Gray *et al.* (1995b) as “requires that independent judges would be able to recognize what was and was not CSR” (p. 81). To develop the checklist instrument, this study requires the choice of groups into which context units can be categorized. Furthermore, content analysis is used as a tool to evaluate comparative degrees and changes in reporting (Guthrie & Abeysekera, 2006). It includes codifying both qualitative and quantitative information into predetermined categories for presentation and reporting of information. Content analysis has been used in prior studies of corporate social reporting to assess the disclosure level of various items (Guthrie *et al*., 2004). It can be seen as “a technique for gathering data that consists coding qualitative information in an anecdotal and literary form into categories in order to derive the quantitative scales of varying levels of complexity” (Abbott & Monsen, 1979, p. 504). Content analysis provides a description of the volume of CSR information disclosed in each category. It also aims to provide information in a systematic, objective and reliable context (Guthrie & Parker, 1990; Krippendorff, 2004).

According to Guthrie and Abeysekera (2006), there are a number of technical standards which should be done to ensure that content analysis is effective. First of all, the units of analysis, which are the classification's categories must be clearly and operationally determined. Second, the data source should be systematic. This means that an item must be defined to see whether it belongs or does not belong to a specific theme. Third, the content analysis should show some attributes for validity and reliability.

4.2.1.1.1 Unit of Record

A recording unit must be gathered by content analysis. The unit of record is "the specific segment of content that is characterized by placing it into a given category" (Holsti, 1969, p. 116). Prior studies in the social disclosure research have been adopted which use the number of pages, words, and/or sentences to assess the level of disclosure, which are the preferred units of analysis in written communications (Gray *et al*., 1995b). Theoretical literature does not give an overpowering explanation for preferring any one of the three units of analysis over the others (Williams, 1999). The positions for using various units are determined due to the meaning given to them and the extent to which each unit provides the appropriate inferences (Gray *et al*., 1995a). This study used the number of sentences to determine the disclosure level of CSR for several reasons. First, Ingram and Frazier (1980, p. 617) chose sentences as the unit of analysis stating that "the sentence was selected as the unit of analysis for the final research since a sentence is easily identified, is less subject to inter judge variations than phrases, classes and themes, and has been evaluated as an appropriate unit in previous research". Second, sentences are more accepted units of written English communication than individual words (Hughes &

Anderson, 1995), as well as the use of single words also has been discarded as "words" do not convey any meaning without sentences (Milne & Adler, 1999). Third, compared with words and pages, a sentence is a conformist unit of speech and writing, but the part of the page measurement as not, whilst also removing the need to compute for, or standardize, the number of words (Walden & Schwartz, 1997; Hackston & Milne, 1996). Fourth, most prior studies (e.g., Abdul Rahman *et al*., 2010; Bukair & Abdul Rahman, 2011; Maali *et al*., 2006) in the content analysis of social disclosure uses sentences as the basis for coding data. Finally, sentence provides perfect, reliable and meaningful data for more analysis (Milne & Adler, 1999; Oxibar & Déjean, 2003).

4.2.1.1.2 Data Source

The researcher needs to determine which document's source of data is used (Unerman, 2000). This step is important in any study of content analysis (Krippendorff, 1980). Previous studies used a number of media of communication such as advertising, survey, public relations and internet websites to demonstrate CSR disclosure (Abu-Baker & Naser, 2000; Gao *et al*., 2007; Joshi & Gao, 2009; Haniffa & Cooke, 2005; Zeghal & Ahmed, 1990). This study employed the annual report as the prime source of information. This is based on the presumption that the annual report is one of the most important and reliable sources of corporate information (Lang & Lundholm, 1993) for several reasons. First, it has been used by investors as the prime source of information for making decisions (Ahmad *et al*., 2003; Harahap, 2003; Zeghal, Mouelhi, & Louati, 2007). Second, it is the most widely recognized document by researchers because it includes information that has a high degree of credibility (Hamid, 2004; Haniffa & Cooke, 2005). Third, it is the only document which provides information on a regular basis, which is required by regulators (Gray *et al.*, 1995a). Finally, it is more accessible for research objectives (Haniffa & Cooke, 2005).

The CSR information is gathered from the reading and analysis of Islamic banks' annual reports. Each item is coded onto coding sheets related to the theme under which the item belongs based on chosen standards. Each incidence of an item was coded according to the number of occurrences and the frequency of incidences. The disclosure nature is counted whether it is quantitative or qualitative, and the frequency of events (i.e., number of sentences) is observed. The study employed the same procedures and exercises that have been used in the literature of corporate environmental reporting to the Islamic social reporting.

4.2.1.1.3 Reliability and Validity

According to Neuendorf (2002), reliability and validity refers to their instruments, which gives similar findings on repeated trials. This means diverse researchers code the content in the same manner, which provides results alike under different conditions at all times. According to Milne and Alder (1999), content analysts require focusing on the reliability of their instruments and the data collected. Reliability can be achieved by two ways. First, the most common way to achieve this is by employing multiple coders. Second, it can create reliability through using a single coder, who has adequate training to reach an acceptable level (Milne & Alder, 1999). Content analysis contains two kinds of reliability: stability and accuracy (Krippendorff, 2004, pp. 130-132). Stability is related to the ability of a coder to code data in the same manner overtime, which can reduce the need for multiple coders, while the reliability analysis in terms of accuracy measures the performance of a review coding with a predefined standard. Guthrie and Mathews (1985) noted that there are no determined standards for CSR disclosure, and as a result, no complete or perfect measure or performance of CSR has been developed. Hence, a researcher can use any approach that achieves the reliability test.

Based on the study of Guthrie *et al.* (2008), this research employed four ways to increase the reliability in recording and analyzing the data. First, the themes of disclosure were developed from the relevant literature.

The measurement of CSR disclosure in annual reports requires a clear definition for CSR disclosure and its themes. From the western perspective, the previous studies identified four main categories for corporate social responsibility, namely: natural environment, employees, community, and customers (Gray, *et al*, 1995b). In the context of *Shariah* teaching, the CSR disclosure contains details of responsibility and accountability before *Allah*, Islamic community, and environment (Haniffa & Hudaib, 2007; Maali *et al*., 2006; Muwazir *et al*., 2006). This guide shows the components of CSR disclosure. The accountability before Allah includes the vision and mission statement, top management, unlawful operations, *Zakah* and SSB. The responsibility to society comprises employees, products/services, Q*uard Hassan*, insolvent client, community involvement, and the accountability to environment (anything related with the conversation of the environment).

CSR disclosure can be defined in the context of Islamic banks as the disclosure of truths, including financial and non-financial information, relating to the interaction of a bank's with its social environment based on the responsibility and accountability before *Allah*, society and environment, as published in the annual reports of a bank or independent reports (Guthrie & Matthews, 1985; Muwazir *et al.,* 2006). This definition states that CSR disclosure contains qualitative and quantitative information and is disclosed in the annual reports of Islamic banks.

While there is no specific definition for CSR disclosure in the context of Islam, Maali *et al*. (2006) identified three broad goals as a basis for the social disclosure of Islamic business organizations:

1. To show conformity with *Shariah* principles and rules, in specific dealing justly with varied groups within a society.
2. To show how the business' activities have influenced the wellfare of the *Ummah* (Muslim society).
3. To help Muslims to fulfill their religious obligations.

All the above works that attempted to define CSR disclosure are derived from the wider concept of accountability that Islamic banks embrace: claiming to obey principles and rules of *Shariah* obliges these banks to consider moral matters differently from conventional banks. Therefore, the definition that is chosen for this study is the definition by Haniffa and Hudaib (2007), Maali *et al*. (2006), and Muwazir *et al.* (2006), by adding a new theme; poverty (Sairally, 2007), because they capture the areas that form the themes within CSR disclosure of the banks.

A research instrument was designed to describe the criteria for determining the social disclosures, covering 75 items relating to fourteen themes as summarized in Table

4.1 in order to systemize the qualitative and quantitative information that is included in the annual reports of Islamic banks. To avoid any overlapping of interpretations, each item was given a clear definition.

Table 4.1
CSR Disclosure Items

Categories	No	Items to be disclosed
1) Vision and mission statement (VMS)	1	Commitments in operating within *Shariah* principles
	2	Commitments to achieve *Baraka* (blessing) and *al-Falah* (successful in the world and the hereafter)
	3	Focus on maximising the return of shareholders
	4	Serving the needs of Muslim community
	5	Offering efficient service to consumer
	6	Emphasizing on the importance of permissible (halal) profit
	7	Commitments to engage in investment activities that comply with *Shariah* principles
	8	Commitments to engage in financing activities that comply with *Shariah* principles
2) Top management (TM)	9	Detail of names and profile of BOD and the management team
	10	Details regarding the qualifications of the management team
	11	Statement on remuneration of the management team
	12	Statement on policy in appointing, re-appointment and dismissal of BOD and management team
3) *Shariah* supervisory board (SSB)	13	Details regarding the qualifications of the profile of SSB
	14	Details regarding the members of the SSB
	15	Statement on remuneration of the SSB members
	16	Statement certifying distribution of profits and losses are made according to Islamic *Shariah*
	17	Statement of recommendations to rectify defects in products
	18	The opinion of SSB regarding the bank's operation
	19	Number of meetings held
4) Unlawful (*haram*) transactions (UT)	20	Nature of unlawful transactions
	21	Reasons for undertaking such transactions
	22	The *Shari'a* Board's view about the necessity of these transactions
	23	The amount of revenue or expenses from these transactions
	24	How the bank disposed, or intends to dispose, of such revenues

Table 4.1 (Continued)

Categories	No	Items to be disclosed
5) *Zakah* (for banks required to pay it) (ZP)	25	Statement of sources and uses of *Zakah*
	26	Statement showing the amount of *Zakah* paid and its computation
	27	The balance of the *Zakah* fund, and reasons for non-distribution
	28	*Shariah* board attestation regarding the computation and distribution of the funds
Zakah (for banks not required to pay it) (ZNP)	29	The amount due in respect of shares and deposits
	30	The *Shariah* board's opinion regarding validity of computation
	31	Sources of funds allocated to *Quard*
6) *Quard Hassan* (QH)	32	The amounts given to beneficiaries
	33	The social purposes for which the funds were given
	34	The policy of the bank in providing such loans
	35	The policy of dealing with insolvent beneficiaries
	36	Sources and uses of charity
7) Charitable and social activities (CSA)	37	The nature of charitable and social activities financed
	38	The amount spent on these activities
	39	The sources of funds used to finance these activities
	40	Employees' appreciation
8) Employees (EM)	41	Number of employees
	42	The policy on wages and other remuneration
	43	The policy on education and training of employees
	44	The policy of equal opportunities towards women and minorities
	45	Working environment
	46	Statement detailing the company's policy on employees' welfare and benefit such as religious provision, holidays and medical benefits
	47	The policy in dealing with insolvent clients
9) Late repayments and insolvent clients (LRIC)	48	The amount charged as late penalty, if any
	49	The policy on late payments by clients
	50	The *Shariah* board's opinion regarding the permissibility of imposing additional charges (such as late penalties
10) Environment (EN)	51	Finance any projects that may lead to environmental harm
	52	Finance any projects friendly to the environment
	53	Conservation of energy in the conduct of business operations
	54	Amount spent on conservation of the natural environment and wildlife
	55	The company's operations are in line with environmental laws and regulation

Table 4.1 (Continued)

Categories	No	Items to be disclosed
11) Products and services (PS)	56	Offering products and services based on *Shariah* principles
	57	Statement stating all products/services are approved by SSB
	58	Description regarding the basis of S*hariah* concepts for each product/service
	59	Policy on marketing is in compliance with Islamic ethical values
	60	Approved new products by SSB
	61	Launching new products and services
	62	Integration and diversity of products and services
12) Customer (CUS)	63	Customer service
	64	Meeting customer needs
	65	Customer satisfaction
13) Poverty (POV)	66	Poverty eradication
	67	Constructing affordable housing
	68	Supporting small business
	69	Supporting home-handiwork
	70	Employment of the disabled
	71	Creating jobs
14) Other aspects of community involvement (OACI)	72	Statement on contributions made to support acts by other organizations for the betterment of the society
	73	The bank's role in economic and social development
	74	Sponsoring Islamic educational and social events
	75	Description of company's participation in government social activities

Sources: Aribi and Gao (2010), Haniffa and Hudaib (2007), Maali *et al*. (2006), Muwazir *et al*. (2006), Sairally (2007).

Second, the reliable coding instruments with well-specified decision rules have been developed to reduce discrepancies and to meet objectivity. Any discrepancy was re-analysed to resolve the variations. By doing so, it can decrease the need for the costly use of multiple coders. The rules covering the content analysis application are shown below:

1. All CSR disclosure must be related to the Islamic bank and its operations.
2. When the same sentence of CSR disclosed more than once in the annual report, it must be recorded each time it is mentioned.

3. Where single sentence of CSR is included more than one idea, the sentence would be recorded related to the activity most emphasized in the sentence.
4. All sponsorship activities contained under the CSR disclosure index are counted, irrespective of how much they are advertised.

Third, the coder has sufficient training to achieve the reliability by reviewing a small sample of annual reports during the pilot study stage.

Testing a sample of annual reports as a pilot study prior to conducting the primary content analysis provided a training experience to the author. This may help to increase the reliability of the outcomes of data (Weber, 1990). Further, this gave the ability to the researcher to be more familiar with the process of content analysis. Five annual reports were randomly selected and analysed as part of the pilot study before coding the main data. The annual reports were coded based on the original content themes that were properly selected and defined. During pilot study, the interpretations of the decision rules were stated and clarified to minimize discrepancies. The themes were discussed with other academicians who have more experience in content analysis.

Lastly, to increase the validity of the instrument, the sentences were chosen as the units of measurement for content analysis (Milne & Adler, 1999).

To examine the internal consistency (the reliability of measurement) of CSR disclosure, Cronbach coefficient alpha was employed (Cronbach, 1951). The examination is based on the average correlation within items (Nunnally & Bernstein, 1994). Cronbach coefficient alpha is used to repeat the measurement for evaluating the degree to which correlation within the measurements is narrow to the random error (Botosan, 1997). The logic behind this examination is that if the inter-correlations within the items are great, the measurement of items will be the same among the construct. Hair *et al.*, (1998), Liouville and Bayad (1998), and Sureshchandar, Rajendran and Anantharaman, (2002) opined that if the Cronbach alpha is less than 0.60, it is considered poor, while it is acceptable at 0.70; whereas, for Cronbach alpha over 0.80 is considered to be more reliable. Table 4.2 represents the Cronbach alpha for each theme of CSR disclosure items by Islamic banks for the year 2008. Table 4.2 shows that the instruments of CSR disclosure that have been used in the current study were reliable with the coefficients ranging from 0.635 to 0.751. The coefficient of Cronbach alpha is 0.697 for all themes, which exceeded the minimum acceptance level of .60. This finding is accepted compared with Cronbach alpha of 0.51 and 0.62 in the study of Gul and Leung (2004) and Aribi and Gao (2010), respectively.

Table 4.2
Reliability Coefficients of CSR Disclosure Themes (N=132)

CSR Disclosure Themes	Cronbach's Alpha Value	Number of Items
Vision and mission statement	.691	8
Top management	.751	4
Shariah supervisory board	.655	7
Unlawful or doubtful transactions	.700	5
Zakah	.696	6
Quard Hassan	.694	5
Charitable and social activities	.690	4
Employees	.642	7
Late repayments and insolvent clients	.689	4
Environment	.698	5
Products and services	.635	7
Customer	.657	3
Poverty	.684	6
Other aspects of community involvement	.667	4

These procedures executed in order to ensure the stability of themes' measurement at the different period.

4.2.1.2 Multivariate Regression

In addition to content analysis, the multivariate technique was used to examine the relationship between the independent variables and the level of CSR disclosure. The research used multiple regression of ordinary least square (OLS) as the main multivariate analysis. OLS is a statistical technique applied to test the hypotheses between the disclosure of CSR information in annual reports of Islamic banks as the dependent variable and corporate governance attributes as the independent variables controlling for size and financial performance. Neuman (2004) defined a dependent variable as "the variable that is the effect or the result of the outcome of another variable" (p. 149). Unlike the dependent variable, independent variables are defined as "forces or conditions that act on something else" (Neuman, 2004, p. 149). According to Tabachnick and Fidell (2006), the multiple regressions can be applied to a data set in which several independent variables are associated with one another and with dependent variable to varying degrees. The goal of OLS is to foresee the individual dependent variable by a set of the independent variables. Each independent variable is weighted by the regression analysis procedure to ensure maximum prediction from the set of independent variables (Hair *et al*., 1998). Bryman and Cramer (1999) suggest that multiple regression is the most widely used method for conducting the multivariate analysis, particular when more than three variables are involved.

Multiple regression (OLS) was used in equation (a), (b) and (c). The models of OLS regression for this study are:

(a) The influence of socio-political factor and corporate governance mechanisms on corporate social responsibility disclosure (CSRD), controlling for bank size and financial performance

$$CSRD = a_0 + a_1 (MUSP) + a_2 (NEBOD) + a_3(SCEO) + a_4(CHAIRP) + a_5(SSB) + a_6(NSSB) + a_7(CROSS) + a_9(PHD) + a_8(REP) + a_{10}(AC) + a_{11}(NAC) + a_{12}(ACACC) + a_{13}(NEAC) + a_{14}(MEET) + a_{15}(AUDIT) + a_{16}(BSIZE) + a_{17}(PERFOR) + \varepsilon$$

(b) The influence of the socio-political factor, board of directors' effectiveness (BODE), the effectiveness of Shariah supervisory board (ESSB) and audit quality (AUDITQ) on corporate social responsibility disclosure (CSRD), controlling for bank size and financial performance

$$CSRD = B_0 + B_1(MUSP) + B_2(BODE) + B_3(ESSB) + B_4(AUDITQ) + B_5(BSIZE) + B_6(PERFOR) + \varepsilon$$

(c) The influence of the socio-political factor and corporate governance score on corporate social responsibility disclosure (CSRD), controlling for bank size and financial performance

$$CSRD = C_0 + C_1(MUSP) + C_2 (CGSCORE) + C_3(BSIZE) + C_4(PERFOR) + \varepsilon$$

Where:

MUSP proportion of Muslim population to total population in a country (the socio-political factor)

NEBOD	proportion of non-executive directors
SCEO	separation role of chairman and CEO, dummy "1" for chairperson ≠ CEO, "0" otherwise
CHAIRP	chairperson Position, dummy "1" if chairperson non-executive director, "0" otherwise
SSB	the existence of *Shariah* supervisory board, dummy "1" if there is a *Shariah* supervisory board, "0" otherwise
NSSB	the number of *Shariah* supervisory board, dummy "1" if the board number is more than 5, "0" otherwise
CROSS	dummy, "1" if the *Shariah* supervisory board having at least one membership in another board, "0" otherwise
PHD	dummy "1" if the number of *Shariah* board having at least one with PhD qualification, "0" otherwise
REP	dummy, "1" if the *Shariah* supervisory board having at least one in the AAOIFI board, "0" otherwise
AC	dummy "1" if there is an audit committee, "0" otherwise
NAC	the number of the audit committee members
ACACC	dummy "1" if the audit committee having at least one with accounting or finance certification, "0" otherwise
AUDIT	auditor type, dummy "1" for Big Four, "0" Non-Big Four

NEAC	proportion of non-executive directors on the audit committee
MEET	the number of the audit committee meetings held in the year.
BSIZE	the number of employees
PERFOR	return on equity (ROE)
BODE	board of directors' effectiveness (NEBOD + SCEO+ CHAIRP)
ESSB	the effectiveness of *Shariah* supervisory board (SSB + NSSB+ CROSS + REP + PHD)
AUDITQ	audit quality (AC + NAC + ACACC + AUDIT + NEAC + MEET)
CGSCORE	corporate governance score (BODE + ESSB + AUDITQ)

The three models are based on previous studies (Farook & Lanis, 2005; O'Sullivan *et al.*, 2008). These models have been used to fit the data in order to assess the effect of two groups as independent variables on the disclosure level of CSR.

4.3 POPULATION AND SAMPLING

The population of this study included all Islamic banks that were operating around the world. These were identified from the list compiled by AAOIFI (2009), Archer and Karim (2002), AIBIM (2009) and Kauthar Bank (2009). This list includes about 325 financial institutions that provide the services of Islamic banking. The annual reports of the banks were obtained mostly from their websites and the relevant web-sites of the stock exchange. Out of 325 banks, only (106) annual reports were available in their websites and the websites of stock exchanges at the time of the study. To expand the sample size, another (74) banks were identified in the sample for which mailing addresses were available. The researcher sent a letter to each bank requesting its 2008 annual report. In general, 26 annual reports of Islamic banks were received giving an overall response rate of 35%. This result is higher than 29.8% in the study of Farook and Lanis (2005), and is lower than 37.5% in the research of Maali *et al.* (2006). As a result, the final sample size reached to 132 annual reports, which equals 40% of the total population (325) from 24 different countries throughout the world (see Table 4.3).

Nevertheless, the sample size needed for running the multivariate regression should preferably be one to ten (Roscoe, 19975), or five (Coakes, 2005; Green, 1991) for each variable tested. The sample size of 100 is quite acceptable (Coakes, 2005; Roscoe, 19975) and manageable within the period of the study (Gan, Saleh, & Abessi, 2008; Li *et al., 2008*).

The fiscal year of 2008 was chosen for this research because most of Islamic banks had already uploaded their annual reports in their websites when the study began in late 2009. Furthermore, it is sufficiently recent to make sure reasonable access to the company's corporate reports, and gives a rational picture of CSR disclosure practice. Given the nature of a research, it limits the research sample to the Islamic banks that operates around the world, because there is a general lack of knowledge of the extent and determinants of CSR disclosure among the banking sector.

Table 4.3
Sample Distribution by Country

Country	Number of banks
Bahrain	22
Bangladesh	4
Bosna	1
Brunei	1
Egypt	2
Indonesia	3
Iran	12
Jordan	2
Kenya	1
Kuwait	17
Malaysia	16
Pakistan	15
Palestine	1
Qatar	4
Saudi Arabia	4
South Africa	1
Sudan	12
Swaziland	1
Syria	1
Thailand	1
Tunisia	1
Turkey	3
UAE	6
Yemen	1
Total	132

Islamic banks are defined as any financial intermediary that claims to act based on the *Shariah* principles and rules (IAIB, 2001). The sample comprises the banks that operate in services and investment, or those companies that operate in mortgage, *Modaraba* and leasing. In order to ascertain that banks are really Islamic banks, the researcher had to read the vision and mission statements and information published on their websites (Farook & Lanis, 2005).

4.4 MEASUREMENT OF VARIABLES

4.4.1 Measurement of Dependent Variable

The present study used the number of sentences published in corporate annual reports to measure the level of CSR disclosure. To determine this level, content analysis was applied. The number of sentences related to each item of CSR in the checklist is coded. The number of sentences associated with every item under the 14 themes was added together to account the total of CSR. The reason behind using the sentence as the unit of analysis is that sentences are much more reliable than any other unit of analysis (Milne and Alder, 1999). They are also easily identifiable which helped the researcher to categorize CSR disclosure smoothly into the predefined themes. In terms of the unit of the measurement, the author used the sentence as recommended by Milne and Alder (1999). They propose that if the researcher is mainly using sentences as the base for coding, he might as well use sentences to count the amount of disclosure, because the additional effort to do, otherwise, is unexpected to yield extra benefits.

4.4.2 Measurement of Independent Variables

This study classified the independent variables into two categories, consisting of socio-political context and corporate governance attributes; the board of directors' effectiveness (BODE), the effectiveness of the *Shariah* supervisory board (ESSB), and the audit quality (AUDITQ) controlling for bank size and financial performance.

The BODE comprises the board's composition, the separation functions of CEO and chairman, and the chairman's position. The ESSB includes the existence of SSB, the number of SSB members, the cross-membership of SSB members, the qualification of SSB members, and the reputable scholars on SSB. Table 4.4 below gives a summary of the definitions of these variables. The AUDITQ consists of the existence of audit committee, the size of an audit committee board, the expertise of audit committee members, the audit committee composition, the frequency of audit committee meetings, and the audit firm's size.

Table 4.4
Summary of the Operationalization of Independent Variables

Independent Variables	Operationalization
Socio-political context-Relevant public	
Proportion of Muslims population	Ratio of Muslim population to total population
Corporate governance	
Board of directors	
Board composition	Ratio of non-executive directors on the board
CEO ≠ Chairman	Dichotomous; 1 if the CEO is not chairman, 0 otherwise
Chairman's position	1 if chairman is non-executive director and 0 otherwise
Shariah Supervisory Board (SSB)	
Existence of SSB	1 if there is SSB, 0 otherwise
Number of SSB members	1 SSB has 5 or more members, 0 if it has < 5
Cross memberships of SSB members	1 if any SSB member has memberships, 0 otherwise
Doctoral qualification of SSB	1 if any SSB member has PhD, 0 otherwise
Reputable scholars on SSB	1 if at least one of SSB members sets at AAOIFI board, 0 otherwise
Audit Quality	
Existence of audit committee	1 if there is an audit committee, 0 otherwise
The size of an audit committee	The total number of an audit committee members
Expertise of an audit committee	1 if any audit committee members has finance or accounting degree, 0 otherwise
Audit committee composition	Ratio of non-executive directors on the committee
Frequency of an audit committee	Number of audit committee meetings per year
Audit firm's size	1 if financial statements audit by Big4, 0 otherwise
Control Variables	
Bank's size	Log of total number of employees
Financial performance	Return on equity (ROE); profit before tax and *Zakah* divided by total equity

4.4.2.1 Socio-Political Context: Relevant Public: Relative Size of Muslim Population

Previous studies have employed a number of factors to determine the social pressure such as media pressure and relevant public (Farook & Lanis, 2005; Reverte, 2009). In the case of Islamic banks, the appropriate proxy to measure the relative size of Muslim population that represents the public pressure is the percentage of Muslim population to total population in a particular country where these banks operate. This study used the same measure that has been used by Farook and Lanis (2005). The source for the ratio of Muslim population over the total population within a particular country in which Islamic banks operate is the WIKIPEDIA (2009).

4.4.2.2 Corporate Governance

The current study uses the same procedure that has been employed by Farook and Lanis (2005) and O'Sullivan *et al.* (2008) to measure the independent variables of corporate governance.

4.4.2.2.1 Board of Directors' Effectiveness

This independent variable contains the board's position, the separation's role of CEO and chairman as well as the position of the chairperson. The study measures a composition of the board by percentage of non-executive directors divided by the total number of directors on the board (Barako & Brown, 2008; Haniffa & Cooke, 2002; Haniffa & Cooke, 2005; Said *et al*., 2009). The separation of chairman and CEO's role is a dichotomous variable used for checking the existence of the dual leadership, where it will be considered as 1 if the CEO and the chairman of the board are separated, 0 otherwise (Coulton *et al*., 2003; O'Sullivan *et al*., 2008; Zeghal *et al*, 2007). The position of chairman refers to its independence as a non-executive director on the board of directors (Coulton *et al*., 2003; Haniffa & Cooke, 2002; O'Sullivan *et al*., 2008).

4.4.2.2.2 The Effectiveness of *Shariah* Supervisory Board (SSB)

The independent variable comprises of six separate attributes. A dichotomous variable is used with a value of 1 if the SSB exists, 0 otherwise. To measure the number of SSB members, zero/one score is used, where 1 is for banks with 5 or more members, otherwise 0 is used. The qualification of SSB members is measured if one of them has a doctorate certification (Farook & Lanis, 2005), because SSB members with PhD degrees would be more knowledgeable and have more experience. The reputation of the scholars on the SSB is measured by the position in the SSB of the AAOIFI, where 1 refers to those with at least two *Shariah* board memberships, 0 otherwise (Farook & Lanis, 2005).

4.4.2.2.3 Audit Quality

The last independent variable of corporate governance relates to the audit role. The study assesses the audit quality through its existence within an Islamic bank and how that committee meets frequently. For example, some Kuwaiti investment and finance companies in the sample do not have audit committees. The position of an audit committee refers to a number of the non-executive directors on the audit committee's board (Bronson, Carcello, & Hollingsworth, 2009). The frequency of meetings of an audit committee is measured by the number of meetings held per annum (Khanchel, 2007; O'Sullivan *et al*., 2008; Yatim, 2009). In addition, a dichotomous variable is used with a value of 1 if one of the audit committee members has finance or accounting qualification, which measures the audit committee expertise (Yatim, 2009), 0 otherwise. The audit firm's size uses a number as a proxy for auditor type, to indicate whether or not the auditor is a Big 4 firm or not (Khanchel, 2007; Yatim, 2009). To measure the type of an auditor, zero/one is used, where 1 refers to the financial statements of Islamic banks audited by Big-Four Companies, otherwise 0.

4.4.2.2.4 Corporate Governance Score

The last independent variable is a score measure of overall corporate governance. The present study calculates the values for categories of the BODE, ESSB and AUDITQ. The BODE has three values (one continuous variable and two binary variables), and the score of the BODE is divided by three. One degree adds to the overall score of CG if the value is more or equal to the average. The ESSB has five values (binary variables), and the score of the ESSB is divided by five. The actual value of variables adds to the overall score of CG. The AUDITQ has six values (three continuous variables and three binary variables), and the score of AUDITQ is divided by six. For continuous variables, one degree adds to the overall score of CG if the value is more or equal to the average, while the actual value of each binary variable adds to the overall score of CG. This study also calculates the overall governance mechanisms' score (CG) for an Islamic bank by adding together the standardized values for each of the previous three variables (O'Sullivan *et al*., 2008). If the value of each variables of BODE, SSBE, and AUDITQ is more or equal to the average, one degree adds to the overall score of CG, which is divided by three.

4.4.2.3 Firm Characteristics as Control Variables

4.4.2.3.1 Bank Size

Prior studies have used a number of proxies to measure the firm's size (Cooke, 1991; Wallace *et al.*, 1994). Some of the measurements of the size of a company are the number of shareholders, turnover, total assets, and the firm's market value. There are no theoretical reasons that clearly justify the choosing of a particular size's measure (Hackston & Milne, 1996). This study follows Branco and Rodrigues (2008b) and Tagesson, Blank, Broberg and Collin (2009) who used the total number of employees for measuring the bank's size at the end of a financial reporting year.

In the CSR disclosure context, there are good reasons that justify the use of the number of employees as a proxy for public visibility. First, the number of employees might be considered as a possible determinant for social pressure derived from the viewpoint that the larger the number of employees, the greater the visibility of the corporation to external stakeholders groups, such as the government and the public in general (Branco & Rodrigues, 2008b). Second, employees are considered as one of the main stakeholder groups and employees' information as an important theme of the CSR disclosure themes, so it seems that the number of employees is considered an appropriate indicator.

4.4.2.3.2 Financial Performance of the Bank

In the context of CSR disclosure, most of the previous studies used the return on asset (ROA) and return on equity (ROE) as proxies for the performance (see, for example, Cowen *et al.*, 1987; Haniffa & Cooke, 2005; Khan, 2010; Li *et al.*, 2008; Patten, 1991; Reverte, 2009). This study follows earlier studies that employed ROE as a proxy for financial performance (Haniffa & Cooke, 2005; Khan, 2010; Menassa, 2010). According to Van Horne and Wachowicz (2005), the ROE is an indicator for measuring the profitability of a company after the whole costs and taxes. It measures the return of investment for per dollar after tax. It is also used to measure the managerial efficiency (Hassan, 1999; Ross, 2001; Sabi, 1996; Samad, 1999).

4.5 SUMMARY

This chapter gives an explanation for the research design employed in the current study. This method includes the unit of recording, data source and reliability and validity of content analysis. This chapter also presents the proposed theoretical models in terms of CSR disclosure determinants. In addition, it provides the approach of data collection for the study's sampling, followed by the measurements of both the dependent and independent variables. The number of sentences is used to measure the quantity of CSR disclosure in the annual reports.

The next chapter provides descriptive results of CSR disclosure in the annual reports of Islamic banks. It also provides the regression results for the three models in order to explain the influence of selected factors on CSR disclosure.

CHAPTER FIVE

RESULTS AND DISCUSSION

5.1 INTRODUCTION

Chapter five explains the results of content analysis in the annual reports of Islamic banks. The significance of the chapter is to provide the current practice of CSR by banks, which is appropriate for testing the proposed framework. The main objectives of this chapter are to:

- Analyze CSR disclosure in the annual reports,
- Analyze the levels of diverse themes of CSR disclosure in annual reports,
- Provide an analysis of the correlation between various independent factors of CSR disclosure,
- Present an analysis of the OLS regression for the three models of CSR disclosure.

This chapter is structured as follows. The chapter is derived from the statistical analysis of the findings of disclosure measurement. The second section reports the overall results of the disclosure level of CSR by Islamic banks, while the third section outlines and discusses the themes of CSR disclosure. The correlation matrices will be explained in the fourth section. The fifth section provides the results of OLS regressions for all models of the study. A summary and conclusion of the content analysis results and multivariate analysis are provided in the last section.

5.2 DESCRIPTIVE ANALYSIS OF THE OVERALL CSR DISCLOSURE

Table 5.1 provides descriptive statistics for all CSR themes and the overall CSR disclosure during the year 2008. This study used the number of sentences to measure the quantity of CSR disclosure in the annual reports. The results show that the minimum disclosure in the annual reports is 19 sentences; indicating that all banks provide some form of CSR disclosure, while the maximum disclosure is 604 sentences. The possible reason behind disclosing some CSR information is that firms in the Islamic banking sector, which are closer to the Muslim community, need to show greater compliance with *Shariah* rules and principles. This signifies that the banks concentrate on the social activities in their operations since they are seen as social enterprises (Maali *et al.*, 2006).

The average number of sentences was 124.08. This average is more than that of the study by Maali *et al.* (2006), with only 25 sentences. Their sample was 29 Islamic banks from 16 countries for the year 2000. This shows an increased interest in the disclosure of CSR information and may partly be due to the higher number of banks in the sample employed in this research.

The interesting feature in Table 5.1 is that top management (TM) was the highest theme of disclosure, followed by themes of products and services (PS) and employees (EM), respectively. These findings are in line with the study by Bukair and Abdul Rahman (2011), which was done in Islamic banks of the Gulf Cooperation Council (GCC). These findings are also partially consistent with the results of a previous study of Haniffa and Hudaib (2007), which shows the popularity of commitment toward debtors and product and services disclosure. This finding is also in conformity with Menassa (2010), who found that the theme of human resources has the highest disclosure followed by quality of products in a sample of Lebanese commercial banks. The environment (EN) and Q***uard*** *Hassan* **(**QH) themes displayed the lowest themes of disclosure. These results are consistent with the study of Bukair and Abdul Rahman (2011), which found both categories had less disclosure than all the other categories. These results are consistent with prior research that found no disclosure (Maali *et al*., 2006), or weakest disclosure regarding the environment (Menassa, 2010; Abul Hassan & Harahap, 2011). The reason behind disclosing more information for top management and products and services are to show the uniqueness of the Islamic banks that comply absolutely with the Islamic *Shariah*. Both themes are important for users of corporate annual reports to assess and judge the ethical business conduct of Islamic banks. On the other hand, there is a lack of disclosure in environment and free interest loans themes. The lack of disclosure in both themes is in contrast with the supposed situation that Islamic social reporting must provide information regarding the environment and free interest loans (Maali *et al*., 2006; Muwazir *et al*., 2006). The possible explanation is that the banking industry has a smaller impact on the environment compared with other sectors (Simpson & Kohers, 2002; Branco & Rodrigues, 2008b), and it has a financial goal for giving *Quard Hassan* than the social objective. Furthermore, it can be seen from Table 5.1 that the level of sentences disclosed varied significantly within the Islamic banks.

In general, disclosing themes of *Zakah*, free interest loans (*Quard Hassan*) and SSB are in line with the studies of Maali *et al*. (2006) and Haniffa and Hudaib (2007), which debates that providing such information is a part of their duties to discharge their accountability towards *Allah*.

Table 5.1
Disclosure Level of CSR Themes

Themes	No. of banks	No. of sentences	Level of disclosure %	Min.	Max.	Mean
TM	131	4806	29.34	0	274	36.41
PS	124	3434	20.97	0	128	26.02
EM	129	1961	11.97	0	72	14.86
SSB	103	1282	7.83	0	93	9.71
CUS	108	1062	6.48	0	64	8.05
LRIC	114	1037	6.33	0	38	7.86
OACI	94	868	5.30	0	79	6.58
VMS	127	651	3.98	0	21	4.93
POV	78	398	2.43	0	65	3.02
ZP	59	275	1.68	0	12	2.08
ZNP	18	30	0.18	0	6	0.23
CSA	49	211	1.29	0	25	1.60
UT	54	137	0.84	0	8	1.04
QH	27	120	0.73	0	16	0.91
EN	20	106	0.65	0	14	0.80
CSRD	132	16378	100%	19	604	124

5.3 THEMES OF CSR DISCLOSURE

In this section, each theme and item in the checklist of CSR disclosure by Islamic banks was analyzed individually.

5.3.1 Top Management (TM)

The top management related to disclosure represents the cornerstone for both shareholders and fund depositors who would like to measure and judge whether the management has full authority in making economic decisions of Islamic banks on their behalf in implementing the principles of *Shariah*. This type of disclosure contains items like the profile and qualifications of BOD and management team. One hundred and thirty-one (131, or 99%) of the Islamic banks in the sample provided some information on the theme of top management (see Table 5.1). Surprisingly, this result is inconsistent with prior studies by Haniffa and Hudaib (2007) and Abul Hassan and Harahap (2011), who found a lack of disclosure in this theme. From this result, it can be seen that Islamic banks seem to give more attention to good corporate governance practice.

Table 5.2
Disclosure Level of Top Management Theme

Items	No. of banks	No. of sentences	Disclosure level %
1. Details regarding the profile of BOD and management team	128	3359	69.89
2. Details regarding the qualifications of BOD and management team	46	671	13.96
3. Statement on remuneration of BOD/management team	109	624	12.99
4. Statement on policy in appointing, re-appointment and dismissal of BOD and management team	60	152	3.16
Total	-	4806	100%

The total number of sentences disclosed under this category was 4806 with an average of 36. Table 5.2 reveals that the profile of BOD and management team is the highest item disclosed in this theme (128 bank), indicating that not all banks in the sample provide some information regarding this item, while the appointment and re-appointment of BOD as well as qualifications of BOD and management team are the lowest items, where only 60 (45%) and 46 banks (35%) respectively provided information related to these items. The low disclosure is due to that these items are voluntary and Islamic banks depending more on the reputation and experience of

BOD members in their appointing and re-appointment rather than their qualifications.

5.3.2 Products and Services (PS)

Islamic banks must avoid any transaction of interest (*riba*) in their dealings, as *Shariah* strongly prevents interest, which is in contrast with the conventional banking system that operates based on interest. Consequently, *Shariah* scholars develop different financial instruments for Islamic banks based on the two main principles, namely: the principle of profit sharing and the principle of mark-up (Aggarwal & Yousef, 2000). Financing instruments derived from the former principle contain *mudharabah* (venture capital) and *musharakah* (partnership arrangement), while the latter instruments, consisting of *murabahah* (resale with stated profit), *bay'al-salam* (forward sale contract), *ijarah* (operating), and *ijarah wa iqtina* (operating and financial lease).

Since Islamic banks are seen as social enterprises, they must offer products and services that do not violate *Shariah* principles and rules. The banks provide information related to products and services, which contains approved products and services from the SSB, offering products and services based on the principles of *Shariah*, description of product or service based on the *Shariah* concept, etc. One hundred and twenty-four (124) banks (94%) in the sample provided information on products and services (see Table 5.1). The result of this theme is higher than the findings of Abul Hassan and Harahap (2011) and Aribi and Gao (2010), who put this dimension as the third ranked of the eight dimensions, and the fifth level within the seven themes respectively. This result is due to the different operational definition and sample size used in the current study. Moreover, this finding is also greater than what was found in the study of Abdul Rahman *et al*. (2010), who ranked this dimension in the third level. The number of sentences disclosed was 3434, which was considerably high. The high number of sentences provided in this theme could be justified, as products and services are the main nearest channel that clients have with the bank, and will therefore be very influential on the bank's reputation. It can be seen from Table 5.3 that the massive disclosure was dominated by the items of quality and diversity of products and services. The table shows that 112 of the banks (85%) disclosed 1284 sentences (37.39%).

Table 5.3
Disclosure Level of Products and Services Theme

Items	No. of banks	No. of sentences	Disclosure level %
1. Offering products and services based on *Shariah* principles	82	667	19.42
2. Statement stating all products and services are approved by SSB	40	157	4.57
3. Description regarding the basis of S*hariah* concepts for each product/service	72	852	24.81
4. Policy on marketing is in compliance with Islamic ethical values	17	34	0.99
5. Approved new products by SSB	8	15	0.44
6. Launching new products and services	74	425	12.38
7. Integrating, quality and diversity of products and services	112	1284	37.39
Total	132	3434	100%

5.3.3 Employees (EM)

Employees are the most valuable asset for a business organization, and the focus should be given to their welfare. From the *Shariah* teachings, Islamic banks are responsible to provide to the employees fair wages, a suitable working environment, and they have the opportunity to practice their religious obligations. Employees should also have equal opportunity for education and training to understand the principles of Islamic banking and have a strong belief in it, which is considered as one of the components for a successful service brand (Chernatony & Segal-Horn, 2001). Therefore, the annual reports should contain information on an appreciation of employees, policy on wages, policy of education and training, welfare of employees, etc. As it can be seen from the main table of CSR themes (Table 5.1), 129 banks (98%) in the sample provided some information regarding the theme of employees. This percentage is greater than the 62% found in the study of Maali *et al.* (2006). Furthermore, this result is higher than the 39.45% in the research of Abdul Rahman *et al.* (2010) for longitudinal data of Bank Islam Malaysia Berhad from 1992 to 2005.

Table 5.4
Disclosure Level of Employees Theme

Items	No. of banks	No. of sentences	Disclosure level %
1. Employees appreciation	84	122	6.22
2. Number of employees	64	123	6.27
3. The policy on wages and other remuneration	44	234	11.93
4. The policy on education and training of employees	77	551	28.10
5. The policy of equal opportunities towards women and minorities	3	5	0.26
6. Working environment	28	73	3.72
7. Statement detailing the company’s policy on employees’ welfare and benefit such as religious provisions, holidays and medical benefits	118	853	43.50
Total	-	1961	100%

Table 5.4 showed that the highest disclosure item under this theme was the employees’ welfare, where 118 (89%) out of 132 banks disclosed 853 (43.50%)

sentences followed by the item of the policy on education and training, where 77 (58%) banks provided 551 (28.10%) sentences. On the other hand, the policy of equal opportunities towards women and minorities was the lowest disclosure item; only 3 Islamic banks provided information related to this item. The finding of this category is partially in line with results of Aribi and Gao (2010) and Abul Hassan and Harahap (2011), who ranked this category in the second and fourth level among all themes and dimensions respectively. Table 5.4 represents the information regarding this theme.

5.3.4 *Shariah* Supervisory Board (SSB)

This theme of corporate governance is unique to Islamic banks. The vast majority of Islamic banks have the *Shariah* Supervisory Board whose main role is acting as an independent internal monitoring mechanism to "give credibility to the operations of Islamic banks by authenticating their legitimacy from the *Shariah* point of view" (Mudawi, 1984, p. 4). The report of SSB should provide assurance to stakeholders, particularly shareholders and investors, which business banking is conducted in compliance with the principles of *Shariah*. The report must also disclose the necessary information to the shareholders, clients and Islamic community at large to enable them to make the rights decisions. Thus, the report of SSB should include profile of SSB members, number of meetings held, attestation that profit was achieved lawfully, etc.

Concerning Table 5.1 of CSR themes, 103 (78%) Islamic banks provide some information related to SSB. The percentage of banks that disclose information regarding SSB is greater than 72%, which is found in the study of Maali *et al*. (2006), but in contrast with previous studies, there are other studies that found this dimension had been given much attention by Islamic banks (Abdul Rahman *et al*., 2010; Abul Hassan & Harahap, 2011; Aribi & Gao, 2010). This level of disclosure is not surprising, since 12 Iranian Islamic banks (9%) out of 132 banks operate in a full-Islamic economy: hence, they do not need to disclose that all their transactions are in line with the principles of *Shariah*. Table 5.5 shows that the high disclosure items are the profile of SSB members and the qualifications of SSB members. 92 banks (70%) provide 785 sentences (61.23%) regarding the members' profile of SSB, while 31 banks (23.48) disclose 169 sentences (13.18) regarding the qualifications of SSB members.

Table 5.5
Disclosure Level of SSB Theme

Items	No. of banks	No. of sentences	Disclosure level %
1. Details regarding the qualifications of Profile of SSB	31	169	13.18
2. Details regarding the members' profile of the SSB	92	785	61.23
3. Statement on remuneration of the SSB members	37	52	4.06
4. Statement certifying distribution of profits and losses are made according to Islamic *Shariah*	47	48	3.74
5. Statement of recommendations to rectify defects in products or operation	20	37	2.89
6. The opinion of SSB regarding the bank's operation	91	146	11.39
7. Number of meeting held	17	45	3.51
Total	-	1282	100%

4.3.5 Customers (CUS)

This category covers three kinds of disclosure items, which include customer service, meeting customer needs and customer satisfaction. The type of information under this theme is much common as shown in Table 5.6. 108 banks (82%) in the sample disclosed 1062 sentences regarding customer category (see Table 5.1 of CSR themes). This finding is the same as the result of Aribi and Gao (2010) which indicated that Islamic financial institutions (18 banks) provide 3853 words, which is in the fourth rank. Customer service represents the highest disclosure item among all items. The low disclosure in this theme is because Islamic banks have limited products and operations where the size of the majority of banks in the sample is small.

Table 5.6
Disclosure Level of Customers Theme

Items	No. of banks	No. of sentences	Disclosure level %
1. Customer service	100	743	69.96
2. Meeting customer needs	74	235	22.13
3. Customer satisfaction	39	84	7.91
Total	-	1062	100%

5.3.6 Late Repayments and Insolvent Clients (LRIC)

Islamic banks, when engaging in dealings of financing mark-up like *Murabaha*, may meet circumstances that their clients were unable to pay some amounts when they fall due. Users of annual reports would like to know how the bank contracts with insolvent clients, and whether the bank contracts with them in conformity with the principles of *Shariah*. Table 5.7 represents the information that might be provided under this category.

Disclosures under this theme were common. Regarding Table 5.1 of CSR themes, 114 (86%) of 132 banks provide information on their late repayment and insolvent clients. Surprisingly, the result is in contrast with the findings of Maali *et al*. (2006)

that showed not one of the Islamic banks disclose any information related to this theme. The high disclosure item was the policy in dealing with the insolvent clients, where 112 banks (85%) disclose 959 (92.48%) sentences. There was a lack of information concerning the opinion of *Shariah* board regarding the permissibility of imposing additional charges, and the amount charged as late penalty. This maybe because banks do not want to disclose information regarding this item, as it has a negative effect on their reputation within the community.

Table 5.7
Disclosure Level of Late Repayments and Insolvent Clients Theme

Items	No. of banks	No. of sentences	Disclosure level %
1. The policy in dealing with insolvent clients	112	959	92.48
2. The amount charged as late penalty, if any	13	18	1.73
3. The policy on late payments by clients	20	57	5.50
4. The *Shariah* Board's opinion regarding the permissibility of imposing additional charges (such as late penalties)	2	3	0.29
Total	-	1037	100%

5.3.7 Other Aspects of Community Involvement (OACI)

According to Zain (1999), the theme of community comes after the theme of employees. This disclosure theme includes certain types of disclosure items such as developing national economic, supporting education, participating in government social activities and contributing to other organizations for the betterment of the community. As shown in Table 5.1 of CSR themes, 94 banks (71%) of the whole sample provided information related to community involvement. The finding is better than 48% (14 banks) as found in the study of Maali *et al.* (2006). The result is also higher than 12.49% in later research of Bank Islam Malaysia Berhad (Abdul Rahman *et al.*, 2010). This result is also consistent with a prior study by Aribi and Gao (2010), who found that 18 banks (71%) provide information regarding this category.

The total number of sentences disclosed under this category was 868 with an average number of 6.58 sentences. Nevertheless, the great disclosure level in this theme might give an opportunity to Islamic banks to define themselves as good citizens in their communities. Table 5.8 showed that there is a lack of disclosure regarding the item of participating in government social activities, where only 14 banks (10.61%) disclosed 37 sentences (4.26%). In addition, the highest disclosure level was the item of sponsoring Islamic educational and social events.

Table 5.8
Disclosure Level of Other Aspects of Community Involvement Theme

Items	No. of banks	No. of sentences	Disclosure level %
1. Statement on contributions made to support acts by other organizations for the betterment of the society	43	93	10.71
2. The bank's role in economic and social development	79	316	36.41
3. Sponsoring Islamic educational and social events	52	422	48.62
4. Description of company's participation in government social activities	14	37	4.26
Total	-	868	100%

5.3.8 Vision and Mission Statement (VMS)

Disclosure relating to the vision and mission statement is one of the most important themes in Islamic social reporting (Haniffa & Hudaib, 2007). Vision and mission information is undoubtedly of major interest to Islamic stakeholders, particularly Islamic investors, to show that Islamic banks operate within *Shariah* principles and rules.

This theme covers many different items of vision and mission related to information, such as commitments in operating within *Shariah* principles, focus on maximizing shareholders' returns, serving the needs of the Muslim community, etc. Table 5.1 of CSR themes shows that 127 (96%) Islamic banks in the sample provided some form of information related to vision and mission. A total number of sentences disclosed in this theme were 651 with an average of 5 for each bank. The finding is higher than that found in the study of Abul Hassan and Harahap (2011), which ranked this dimension as the lowest disclosure dimension.

Table 5.9
Disclosure Level of Vision and Mission Theme

Items	No. of banks	No. of sentences	Disclosure level %
1. Commitments in operating within *Shariah* principles	116	319	49.00
2. Commitments to achieve *Baraka* (blessing) and *al-Falah* (successful in the world and the hereafter)	1	1	0.15
3. Focus on maximising shareholders returns	52	79	12.14
4. Serving the needs of Muslim community	33	44	6.76
5. Offering efficient service to consumer	30	44	6.76
6. Emphasizing on the importance of permissible (halal) profit	13	16	2.46
7. Commitments to engage in investment activities that comply with *Shariah* principle	26	36	5.53
8. Commitments to engage in financing activities that comply with *Shariah* principles	58	112	17.20
Total	132	651	100%

As it can be seen from Table 5.9, the level of sentences disclosed varied significantly within the Islamic banks. The item of commitments in operating within *Shariah* principles is the highest item disclosed in this theme followed by the item of commitments to engage in financing activities that comply with *Shariah* principles. In contrast, the item of commitments to achieve *Baraka* (blessing) and *al-Falah* (successful in the world and the hereafter) was the lowest item disclosed followed by the item of emphasizing on the importance of permissible (halal) profit. The low disclosure because all Islamic banks transactions must comply with *Shariah* rulings, so there is no need to provide more information related to these items, as they disclose information about their unlawful activities.

5.3.9 Poverty (POV)

In recent years, firms are expected to contribute in solving social issues like poverty (Kok *et al*., 2001), which is one of the major objectives of Islamic banks. The management of Islamic banking industry may legitimize its existence by providing information on the positive operations of the bank to eradicate poverty, support small business and home-handy work, eliminate unemployment and create job opportunities. However, information regarding the poverty theme was relatively moderate, being provided by 78 banks (59%) of the whole sample (see Table 5.1 of CSR themes).

The information disclosed under this category tended to fall into two items: primarily supporting small business and constructing affordable and safety housing. 49 banks (37%) provided 202 sentences (50.75%) related to supporting small business, while

35 banks (26.5) disclosed 117 sentences (29.40%) concerning the item of constructing safe housing.

Table 5.10
Disclosure Level of Poverty Theme

Items	No. of banks	No. of sentences	Disclosure level %
1. Poverty eradication	13	43	10.80
Constructing and rebuilding affordable and safe housing	35	117	29.40
3. Supporting small business	49	202	50.75
4. Supporting home-handy work	4	5	1.26
5. Employment of disabled	2	2	0.50
6. Creating jobs	14	29	7.29
Total	-	398	100%

5.3.10 *Zakah* (ZP/ZNP)

Zakah is the third pillar of Islam. Since there is a debate among scholars of the *Shariah* whether corporations have to pay Zakah or not, this theme is divided into two types: banks that pay *Zakah* (ZP) and banks that do not pay *Zakah* (ZNP). According to The Islamic Figh Academy Conference in 1984, which was held in Kuwait, it is not mandatory for businesses to pay *Zakah*, unless it is required by the law (Maali *et al*., 2006).

This category contains a lot of information concerning *Zakah*. Zakah is a kind of charity, which is paid in conformity with the Shariah principles. From an Islamic perspective, shareholders and depositors are responsible to give *Zakah* on their money invested in the banks (Maali *et al*., 2006). Table 5.11 in the following represents information related to this theme.

Table 5.11
Disclosure Level of Zakah Theme

Items	No. of banks	No. of sentences	Disclosure level %
1. Statement of sources and uses of *Zakah*	26	75	24.59
2. Statement showing the amount of *Zakah* paid and its computation	57	152	49.84
3. The balance of the *Zakah* fund, and reasons for non-distribution	11	12	3.93
4. Shariah Board attestation regarding the computation and distribution of the funds	30	36	11.80
5. The amount due in respect of shares and deposits	9	12	3.93
6. The *Shariah* Board's opinion regarding validity of computation	13	18	5.91
Total	-	305	100%

As shown in Table 5.1 on CSR themes, 77 banks (58%) in the sample disclose information regarding *Zakah*. There are 59 (45%) banks that are required to pay *Zakah* against 73 (55%) banks that are not required to pay it. Banks that pay *Zakah* provided 275 sentences, while banks that do not pay *Zakah* disclosed 30 sentences. The full percentage of banks that pay *Zakah* is higher than 90% as found in Maali *et al*. (2006), but it is less for banks that do not pay *Zakah* 26%. Furthermore, the result of this study indicates that it is greater than 6.74% as found in the study by Abdul Rahman *et al.* (2010). Table 5.11 showed that the majority of disclosures for both groups were related to the policy of the bank towards *Zakah* and its computation where by 57 banks (43%) provided 152 sentences (49.84%). Further, the results revealed that the statement of sources and uses of *Zakah* comes under the second ranking where 26 banks disclose 75 sentences (24.59%). In addition, the lowest disclosure item was the amount due in respect of shares and deposits, as shown in Table 5.11.

5.3.11 Charitable and Social Activities (CSA)

Donations in Islam are voluntary and were mentioned in many verses of the *Qur'an*. Islamic banks should provide such information to shareholders and the Muslim community about their participations to the society's welfare by helping the poor and needy people. This theme covers a number of items, including the sources of funds used for charity, the nature of charitable and social activities financed by the bank, and the amount spent on these activities. It is evident from Table 5.1 of CSR themes that few banks disclose information on charity and social activities, where only 49 banks (37%) of the total sample gave 211 sentences. This result is somewhat lower than 41% that was found in previous studies (Maali *et al*., 2006). Table 5.12 includes the items related to this theme.

The highest disclosure item under this theme was the nature of charitable and social activities financed by the bank where 23 banks disclose 79 sentences (37.44%) followed by the item of the amount spend on these activities where 39 banks provide 74 sentences (35.07%). On the other hand, the item of source of funds used to finance these activities was lowest; where only 6 Islamic banks provide 7 sentences (3.32%).

Table 5.12
Disclosure Level of Charitable and Social Activities Theme

Items	No. of banks	No. of sentences	Disclosure level %
1. Sources and uses of charity	22	51	24.17
2. The nature of charitable and social activities financed by the bank	23	79	37.44
3. The amount spent on these activities	39	74	35.07
4. The sources of funds used to finance these activities	6	7	3.32
Total	-	211	100%

5.3.12 Unlawful Transactions (UT)

Islamic banks are not allowed to deal with any operation that violates the principles of the *Shariah*. However, in some situations, the bank is required by law to enter into prohibited transactions.

Table 5.13
Disclosure Level of Unlawful Transactions Theme

Items	No. of banks	No. of sentences	Disclosure level %
1. Nature of unlawful or doubtful transactions	10	12	8.76
2. Reasons for undertaking such transactions	2	2	1.46
3. The *Shariah* Board's view about the earnings of unlawful transactions	36	46	33.58
4. The amount of revenue or expenses from these transactions	12	18	13.14
5. How the bank disposed, or intends to dispose, of such revenues	37	59	43.06
Total	-	137	100%

Because the bank may deal with transactions that are not in line with the principles of Islam, and therefore, concerned as unlawful (*Haram*) by the *Shariah,* the bank should provide information about these operations to the Islamic society as part of its accountability toward *Allah* and the community. This theme contains many items like the nature of illegal transactions, the opinion of the *Shariah* board about these transactions, the amount of revenue or expenses from these activities, etc. Table 5.1 of CSR themes shows that 54 banks (41%) in the sample provide some form of information within this category. This finding is in line with the study by Maali *et al*. (2006) that found that the same percentage of banks (41%) published information related to unlawful (*haram*) transactions. This result is also better than what was found in the study by Abdul Rahman *et al.* (2010), which indicated that Bank Islam Malaysia Berhad does not provide any information regarding this theme.

The information disclosed tends to fall into two major items; namely, how the bank disposed unlawful revenues and supervisory board's view about these earnings. From Table 5.1 above, it can be seen that 37 banks (28%) provided 59 sentences (43.06) about the fifth item, while 36 banks (27%) provided 46 sentences (33.58) regarding the third item. The lowest disclosure was the item of reasons for undertaking unlawful transactions, indicating that Islamic banks do not want to provide more information related this item because they do not have convincing reasons for the community to explain why they engaged in these transactions.

5.3.13 *Quard Hassan* (QH)

Islamic banks gave this type of loan to low-income employees and the needy people. Generally, *Quard Hassan* (free interest loan) provides for social benefit goals such as marriage, and in some situations provided to commercial clients who are in financial difficulties.

Unexpectedly, only 27 Islamic banks (20.45%) of the total sample provided information related to this theme (see Table 5.1 of CSR themes). This result is still higher than 14% of banks disclosed information regarding *Quard Hassan* in a study by Maali *et al*. (2006). Furthermore, this finding is also greater than 1.88% in the study by Abdul Rahman *et al*. (2010) among Bank Islam Malaysia Berhad for the period from 1992 to 2005. The important item disclosed under this category is the amount given to the beneficiaries as can be seen from Table 5.14, while the policy of the bank in providing such loans was the lowest disclosure item, indicating that banks do not want to publish in their annual reports the requirements giving loans.

Table 5.14
Disclosure Level of Quard Hassan Theme

Items	No. of banks	No. of sentences	Disclosure level %
1. Sources of funds allocated to *Quard*	9	16	13.33
2. The amounts given to beneficiaries	24	54	45
3. The social purposes for which the funds were given	12	37	30.83
4. The policy of the bank in providing such loans	5	5	4.17
5. The policy of dealing with insolvent beneficiaries	4	8	6.67
Total	-	120	100%

5.3.14 Environment (EN)

Islam prohibits any kind of harmful effect to an individual as well as the society. Islamic banks are responsible to contribute in protecting the environment by providing donations to the community. This theme of disclosure contains issues regarding policy of the financing projects; the amount spent on environmental activities, and conservation of energy in the conduct of business operations, etc.

The number of the banks provided information within this category was very low. Concerning Table 5.1 of CSR themes, only 20 banks (15%) in the sample provided 106 sentences concerning the environmental issues. This result is consistent with the studies of Abul Hassan and Harahap (2011) and Menassa (2010) that found the environment is the lowest disclosure theme within all themes. Moreover, this finding is also better than the results in the study by Abdul Rahman *et al.* (2010) and Maali *et al*. (2006), which did not provide any type of information related to this theme. The most disclose item under this theme was the policy of financing projects that may lead to harm that will have an effect on the environment as shown in Table 5.15. Both conservation of energy in the conduct of business operations and amount spend on conservation of natural environment and wildlife were the lowest disclosure items, indicating that Islamic banks give less concern for these items.

Table 5.15
Disclosure Level of Environment Theme

Items	No. of banks	No. of sentences	Disclosure level %
1. Finance any projects that may lead to environmental harm	12	59	55.66
2. Finance any projects that are user friendly to the environment	7	37	34.91
3. Conservation of energy in the conduct of business operations	2	3	2.83
4. Amount spend on conservation of natural environment and wildlife	1	3	2.83
5. The bank's operations are in line with environmental laws and regulation	2	4	3.77
Total	-	106	100%

5.4 MULTIVARIATE ANALYSIS

5.4.1 Descriptive Statistics

The descriptive statistic for CSR disclosure has been explained in the last section. Table 5.16 presents this analysis for the continuous independent variables with the dependent variable. The mean of Muslim population is considered a high percentage (82.04%), which represented the Islamic community to the total population of the society, but it is lower compared with 93% in a study by Farook, Hassan and Lanis (2011).

Table 5.16
Descriptive Statistics for CSR Disclosure and Continuous Variables

Variables	Min	Max	Mean	Med.	Std. Dev.	Skewness	Kurtosis
CSRD	19	604	124.08	87.50	101.70	2.10	6.05
MUSP	0.20	99.5	82.04	84.70	19.36	-2.13	6.16
NEBOD	14	100	83	87.5	19.10	-1.71	2.84
NAC	0.00	5	2.99	3	1.05	-1.50	3.86
NEAC	0.00	100	87	100	29	-2.28	3.90
MEET	0.00	34	4.64	4	4.37	4.67	25.37
BODE	0.00	100	76.11	100	30.90	-1.30	0.87
SSBE	0.00	100	43.18	40	27.72	-0.10	-0.66
AUDITQ	0.00	100	69.69	67	20.17	-0.78	0.84
CGSCORE	19	94	62.93	63	17.18	-0.67	0.35
BSIZE	18	43000	2151.19	491	5734.27	4.82	26.35
PERFOR	-39.87	46.21	10.78	0.10	12.98	-0.44	1.83

Definitions: CSRD – corporate social responsibility disclosure; MUSP – proportion of Muslim population to total population of the country, NEBOD – percentage of non-executive directors to whole directors on the board; NAC - the number of audit committee members; NEAC - percentage of non- executive directors on the audit committee; MEET - the number of the audit committee meetings held in the year; BODE – board of directors' effectiveness; SSBE – *Shariah* supervisory board's effectiveness; AUDITQ – audit quality; CGSCORE – corporate governance score; BSIZE - the number of employees, PERFOR – performance is measured by return on equity (ROE).

Regarding governance factors, the findings reveal that the banks pursue good corporate governance mechanisms as shown by the percentage of non-executive directors on the board, the number of audit committee members, the independence of audit committee and the number of audit committee meetings. The average percentage of non-executive board of directors (NEBOD) is 83%, indicating that around 83% of the board directors are non-executive directors (NED). The average of NEBOD is considered a great proportion compared with 0.32 in Bangladeshi financial institutions (Khan, 2010), 0.55 in Australian firms (O'Sullivan *et al.*, 2008), and 0.45 in Malaysian companies (Haniffa & Cooke, 2002). This result is consistent with the best practice of corporate governance for Islamic financial institutions that requires the majority of the board of directors to be non-executives.

For the audit quality (AUDITQ), the mean number of an audit committee (NAC) is three, which is lower than that found in the previous study by Khanchel (2007) of 3.74, while more than three-fourth of the audit committee is occupied by non-executive directors, which is higher compared with two-third in the study by Akhtaruddin and Haron (2010). This finding is in line with AAOIFI standards that require at least the audit committee to comprise of three members, most of whom are non executives. In addition, the audit committees of Islamic banks with more than four meetings (MEET) held per annum is slightly greater than 3.87 that found in the study by Khanchel (2007).

For the factors of the board of directors' effectiveness (BODE), the effectiveness of *Shariah* supervisory board (SSBE), audit quality (AUDITQ) and corporate governance score (CGSCORE), the results show that the mean percentages of those variables are 0.76 (76%), 0.43(43%, 2.16), 0.697 (69.7%) and 0.629 (62.9%, 1.88) respectively. This result is higher than 0.589 and 0.568 that found in O'Sullivan *et al.* (2008) for a sample of 200 Australian firms for two years, indicating a higher effectiveness of the board of directors in the sample. The mean of SSBE (2.16) is less than 2.60 as that found in a previous study by Farook *et al*. (2011). This may reflect that the SSB is not effective enough in influencing the bank's management to disclose CSR information. The average of AUDITQ (69.69%) is considered a high percentage compared with 67.6% found by O'Sullivan *et al.* (2008) for Australian companies in 2000. The mean CGSCORE of the three variables 1.889 (63%) is lower compared with 2.7 (67.5 %) for four factors in the study of O'Sullivan *et al.* (2008).

The results of the company characteristics reveal that the mean of the number of employees is 2151 which shows that the banks' size in the whole sample was small compared with 3253 employees by the study of Baranco and Rodrigues (2008b) in Portuguese banks. The average percentage of financial performance as measured by the return on equity (ROE) is 10.778%.

Table 5.17 presents the descriptive statistics for binary variables. Regarding the board of directors, the findings reveal that 113 banks (85.6%) in the sample have separated the position of chairman and CEO, which is higher than 31.2% in a US sample (Khanchel, 2007) and 41% in a study by Kelton and Yang (2008). This result is consistent with the best practice of corporate governance for Islamic financial institutions that requires the two occupations to be held by different persons. Again, 110 (83.3%) banks have the non-executive chairperson, which is better than 81.5% in Australian corporations (O'Sullivan *et al*., 2008). This finding is not in conformity with the best practice of corporate governance for Islamic financial institutions that requires that the chairman to be a non-executive director and independent from management at the same time.

Concerning SSB, 103 (78%) banks have the *Shariah* board, while others do not require. This is because some countries such as Iran, where banks operate in the full Islamic economic system; do not need to review the documents of bank's transactions from SSB. In Kuwait, for example, several investment and finance companies have *Shariah* Advisors instead of the SSB.

Table 5.17
Descriptive Statistics for Binary Variables

Variables		Freq	%	Min	Max	SD
SCEO	CEO & chairman	19	14.4	0	1	.352
	CEO ≠ chairman	113	85.6			
CHAIRP	Executive	22	16.7	0	1	.374
	Non-executive	110	83.3			
SSB	Have	103	78	0	1	.416
	Not have	29	22			
NSSB	More than 5	96	72.7	0	1	.447
	≤ 5	36	27.3			
CROSS	Have	102	77.3	0	1	.421
	Not have	30	22.7			
PHD	Have	98	74.2	0	1	.439
	Not have	34	25.8			
REP	Have	114	86.4	0	1	.345
	Not have	18	13.6			
AC	Have	122	92.4	0	1	.266
	Not have	10	7.6			
ACACC	Have	108	81.8	0	1	.387
	Not have	24	18.2			
AUDIT	Big 4	98	74.2	0	1	.439
	Non-Big 4	34	25.8			

Definitions: SCEO – separation role, dummy "1" for chairperson ≠ CEO; "0" otherwise, CHAIRP - chairperson position, dummy "1" if chairperson non-executive director, "0" otherwise; SSB - the existence of *Shariah* supervisory board; NSSB - the number of *Shariah* supervisory board, dummy "1" if the board more than 5, "0" otherwise; CROSS – the number of *Shariah* board having at least one with membership in another board; REP - the number of *Shariah* board having at least one in the board of AAOIFI; PHD - the number of *Shariah* board having at least one with PhD qualification; AC - the existence of the audit committee; ACACC - the number of the audit committee having at least one with accounting or finance certification; AUDIT - auditor type, dummy "1" for Big Four, "0" Non-Big Four.

In addition, 102 (77.3%) banks have cross memberships, 114 (86.4%) banks have members set in the board of AAOIFI, and 98 (74.2%) banks have members with PhD qualifications.

Regarding the audit quality, 122 (92.4%) banks have the audit committee, which is lower than 96% in O'Sullivan *et al*. (2008). This is because some financial and investment companies in Kuwait, for example, do not have audit committees. Furthermore, 108 (81.8%) banks have members of audit committees with accounting or finance certifications compared with 50% and 61.2% in studies by Akhtaruddin and Haron (2010) and Khanchel (2007) respectively. These findings are not consistent with the best practice of corporate governance that requires all Islamic financial institutions to have audit committees. Most financial statements of the banks (74.2%) in the sample were audited by the Big-four firms, which are considered higher than 66.9% in Khanchel (2007) and 67% in Akhtaruddin and Haron (2010).

5.4.2 Results of Correlations

Table 5.18 illustrates the correlation's matrix between the dependent variable and independent variables employed in the multiple regression of the study. The table demonstrates the greatest correlation is between the separation's role of CEO and Chairperson and the position of Chairman at the 1% level (coefficient = -0.859). The study uses variance inflation factors (VIF) to assess the effect of multicollinearity in each regression model.

The findings reveal that Muslim population is significantly positively correlated with CSR disclosure level. It shows a strong correlation between the percentage of the Muslim population and the CSR disclosure. Regarding corporate governance mechanisms, most findings reveal that governance factors are greatly significantly correlated with CSR disclosure except for the role of duality and the choice of the audit firm. The analysis shows that CSR disclosure is positively correlated with the percentage of the non-executive on the board's directors, the chairman's position, all *Shariah* supervisory board's characteristics, the existence of the audit committee, the audit committee's members with accounting or finance certifications and audit committee's meetings. The coefficient of correlations also reveals that CSR disclosure is negatively associated with the size of an audit committee and the percentage of non-executive directors on an audit committee. These findings indicate a high correlation with CSR disclosure for the governance variables. Concerning controlling variables of firm's characteristics (BSIZE, PERFOR), the findings show that company attributes variables are greatly significantly correlated with CSR disclosure. These findings of the correlation matrix are consistent with previous studies and therefore, give some support for the index of CSR disclosure that is used the study.

Table 5.18 shows some highly correlated between the boards of directors' attributes. The study indicates that as the non-executive directors' increases, the independence of the chairperson decreases (correlation of Pearson-0.194, $p < 0.05$). The existence of the separation of CEO and Chairman's function leads to reduce the chairperson's independence (correlation of Pearson -0.859, $p < 0.01$). In terms of SSB characteristics, there are also correlations among them. Increasing the number of

SSB will increase the proportion of SSB with PhD qualifications (correlation of Pearson 0.283, $p < 0.01$). An increase in SSB with cross-memberships leads to an increase in the ratio of SSB with PhD certifications as well as the members of SSB who sit at the board of AAOIFI (correlation of Pearson 0.627 and 0.278, $p < 0.01$ respectively). These findings imply that there are correlations between factors that affect audit quality. An increase in the number of an audit committee will decrease the ratio of the audit committee with accounting or finance degree, but increases the independence of the audit committee (coefficient -0.336 and 0.546, $p < 0.01$ respectively). A decrease in the number of an audit committee results in an increase in the proportion of members with accounting or finance certifications as well as the frequency of meetings (coefficient -0.358 and 0.319, $p < 0.01$ respectively). Increasing the frequency of meetings leads to a reduction of the audit committee's independence.

The findings of the correlation indicate that large Islamic banks are found to be profitable, and have more frequent meetings of the audit committee, which is in line with the results of Menon and Williams (1994), and have more cross-memberships in the SSB, as well as have more members with accounting or finance certifications in an audit committee compared with the smaller banks. This result is in conformity with the study of Deli and Gillan (2000), who found that bigger companies need more accounting qualifications by the audit committee than the smaller ones.

Table 5.18

Pearson and Spearman Correlation Matrix for Model 1

Variables	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
1 CSRD	1	.167	.178*	-.125	.205*	.197*	.167	.501**	.185*	.257**	.237**	-.308**	.328**	-.241	.390**	.066	.313**	.196*
2 MUSP	.222*	1	-.111	-.307**	.340**	.547**	.225**	.349**	.516**	.262**	.102	-.298**	.101	-.111	-.054	.115	-.115	.057
3 NEBOD	.218*	-.083	1	.186*	-.272**	-.079	-.193*	.180*	-.164	.177*	.085	-.046	-.004	.030	.195*	.014	-.027	-.023
4 SCEO	-.120	-.299**	.126	1	-.859**	-.199*	.040	-.171	-.104	-.163	-.046	.092	-.081	.058	.013	-.104	.190*	-.087
5 CHARP	.194*	.331**	-.194*	-.859**	1	.303**	.046	.194*	.248**	.178*	.026	-.102	.105	-.024	-.076	.108	-.077	.136
6 SSB	.204*	.450**	-.025	-.199*	.303**	1	.325**	.288**	.817	.158	-.083	.028	.013	.193*	-.121	.273**	-.066	-.106
7 NSSB	.177*	.190*	-.198*	.040	.046	.325**	1	.155	.283**	.005	.047	-.130	.064	-.024	.030	.088	.207*	.052
8 CROSS	.519**	.353**	.211*	-.171	.194*	.288**	.155	1	.278**	.627**	.155	-.220*	.119	-.084	.298**	.113	.082	.093
9 PHD	.192*	.423**	-.121	-.104	.248**	.817**	.283**	.278**	1	.133	-.103	-.027	.053	.142	-.138	.247**	.004	-.049
10 REP	.231**	.300**	.162	-.163	.178*	.158	.005	.627**	.133	1	.030	-.159	-.016	-.011	.069	.184*	-.080	-.001
11 AC	.218*	.108	.087	-.046	.026	-.083	.047	.155	-.103	.030	1	-.516**	.135	-.558**	.153	-.038	.216*	.087
12 NAC	-.328**	-.343**	-.050	.121	-.119	.096	-.129	-.209*	.065	-.147	-.662**	1	-.358**	.240**	-.264**	-.092	-.142	-.151
13 ACACC	.363**	.086	.032	-.081	.105	.013	.064	.119	.053	-.016	.135	-.336**	1	-.069	.352**	.053	.267**	.216*
14 NEAC	-.243**	-.196*	.038	.071	-.037	.199*	-.027	-.112	.150	-.038	-.671**	.546**	-.095	1	-.232**	.146	-.182*	-.184*
15 MEET	.251**	.060	.065	.064	-.065	-.036	.133	.128	-.021	.023	.108	-.159	.319**	-.156	1	-.156	.197*	.012
16 AUDIT	.025	.103	.008	-.104	.108	.273**	.088	.113	.247**	.184*	-.038	-.024	.053	.167	-.014	1	-.312**	-.136
17 BSIZE	.307**	-.129	-.020	.235**	-.119	-.117	.193*	.072	-.049	-.065	.220**	-.184*	.252**	-.205*	.315**	-.330**	1	.169
18 PERFOR	.257**	.037	.058	-.159	.196*	-.118	.049	.132	-.057	.017	.113	-.235**	.230**	-.247**	.058	-.185*	.185*	1

*. Correlation is significant at the 0.05 level (2-tailed). **. Correlation is significant at the 0.01 level (2-tailed). The upper is the Spearman correlation, while the other is Pearson correlation.

Table 5.19 shows that all the variables in the second model are highly significantly associated with CSR disclosure except the board of directors' effectiveness (BODE). The results of the BODE and the audit quality (AUDITQ) are in line with the study of O'Sullivan *et al.* (2008), and the findings of *Shariah* supervisory board's effectiveness (ESSB) is in line with prior research by Farook *et al*. (2011). Of the control variables, both bank size (BSIZE) and financial performance (PERFOR) are inconsistent with previous studies (O'Sullivan *et al.*, 2008).

Table 5.19
Pearson Correlation Matrix for Model 2

Variables	CSRD	BODE	ESSB	AUDITQ	BSIZE	PERFOR
CSRD	1					
BODE	.088	1				
ESSB	.394***	.263***	1			
AUDITQ	.402***	-.006	.063	1		
BSIZE	.307***	-.114	.017	.171*	1	
PERFOR	.257***	.238***	.007	.086	.185**	1

***, **, * indicate two-tailed significance at $p < 0.01$, $p < 0.05$ and $p < 0.10$, respectively.

The correlations between CSR disclosure and the overall measure of corporate governance as well as the two control variables (BSIZE and PERFOR) are presented in Table 5.20.

Table 5.20
Pearson Correlation Matrix for Model 3

Variables	CSRD	CGSCORE	BSIZE	PERFOR
CSRD	1			
CGSCORE	.421**	1		
BSIZE	.307**	.007	1	
PERFOR	.257**	.181*	.185*	1

** and * indicate two-tailed significance at $p < 0.01$ and p < 0.05.

The table 5.20 indicates that CGSCORE, and both BSIZE and PERFOR are highly correlated with CSR disclosure. The results of CGSCORE and BSIZE are consistent with the study of O'Sullivan *et al.* (2008), while PERFOR is not.

5.4.3 Regression Analysis

5.4.3.1 Regression Diagnostics

Before conducting regression analyses, the study tested all assumptions of OLS regression for the dependent and independent variables for the three models. The main assumptions are linearity, normality, heteroskedasticity, multicollinearity and outliers.

5.4.3.1.1 Linearity

The assumption of linearity assumes that the relationship between the dependent variable and instrumental variables is linear. The assumption of linearity can be tested by employing both graphical and statistical techniques. Thus, this study will focus only on the statistical analysis. The linearity is determined by using residuals' analysis. Residuals can be defined as the divergence between the observed values of the dependent variable with the value predicted by the line of the regression (Norusis, 1995). Examining linearity is based on the standard deviation of the dependent variable and the standard deviation of the residuals. In other words, according to Hair *et al*. (2010), non-linearity is not a problem if the standard deviation of the residuals is less than the standard deviation of the predictor value. To remedy linearity, data transformation is used to show the relationship of the non-linearity.

5.4.3.1.2 Normality

This assumption means that the errors or residuals' distribution is assumed to be normal. The assumption is required for testing the hypotheses. To test normality in multiple regressions such as OLS, both the independent variables and the predictor value (regression model) are conducted. As there is no direct way to determine multivariate normality, each variable is examined individually by using the statistical tests, comprising of skewness and kurtosis. According to Hair *et al*. (2010), the data of a variable is reasonably close to being normal if the skewness and kurtosis's standard is between ±1.96 (at 0.05 significant levels) and ± 2.58 (at 0.01 significant levels). Each variable which is not normally distributed is transformed into a normal format. There are many approaches to transform a variable to a normal distribution, namely the normal scores, log, square root and inverse. The study uses the normal score method as suggesting by Cooke (1998), which is similar to the approach used by Van der Waerden (1952, 1953) in the SPSS package. This is done by transforming the actual cases to the normal distribution by dividing the distribution into the number of cases plus one region on the basis that each region has equal probability. According to Haniffa and Cooke (2002), the most important features by using this approach are that the tests have the same statistical properties, and the *F*, *t*-test and regression coefficients are more meaningful. Furthermore, the normal distribution of the dependent variable assumes that errors would be normally distributed by the OLS's assumptions. This technique was used in the area of social disclosure by Haniffa and Cooke (2002, 2005). Before running regression analysis, normal score was used for transformation of both the dependent and independent continuous variables to normal distribution. The following table explains the normal distribution of skewness and kurtosis before and after the transformation.

Table 5.21
Normal Distribution of Skewness and Kurtosis

Variables	Before transformation		After transformation	
	Skewness	Kurtosis	Skewness	Kurtosis
CSRD	2.10	6.05	0.970	0.492
MUSPOP	-2.13	6.16	0.868	0.345
NEBOD	-1.71	2.84	0.066	0.023
NAC	-1.50	3.86	0.352	0.031
NEAC	-2.28	3.90	0.000	0.058
MEET	4.67	25.37	0.821	0.616
BORE	-1.30	0.87	-1.30	0.87
SSBE	-0.10	-0.66	-0.10	-0.66
AUDITQ	-0.78	0.84	-0.78	0.84
CGSCORE	-0.67	0.35	-0.67	0.35
BSIZE	4.82	26.35	0.988	0.523
PERFOR	-0.44	1.83	-0.44	1.83

5.4.3.1.3 Heteroskedasticity

The second assumption is heteroskedasticity. Heteroskedasticity means that the variance of a variable must be constant, showing the similar amounts of difference across the range of values for the independent variable. The assumption of heteroskedasticity is much more important than the assumption of normality. It is the result of non-normality of one of the variables (Tabachinck & Fidell, 2007), and it is commonly found in the cross-sectional studies because there are huge diversities in size among observations. Heteroskedasticity is a problem if the variance of the residuals is non-constant, indicating that residuals should be randomly dispersed throughout the predicted value of the dependent variable. In other words, if the model is well-fitted, there should be no pattern to the residuals plotted against the fitted values. There are many graphical and statistical tests to evaluate heteroskedasticity.

According to Hair *et al*. (2010), data transformations are used to remedy heteroskedasticity. To examine the existence of heteroskedasticity, graphic and STATA packages' analyses (statistical method) are employed. To detect the problem of heteroskedasticity, both White and Breusch-Pagan tests were used. The White test is suggested by Gujarati (1995). This test includes the regression of the square error from the ordinary least square (OLS) regression on the dependent variable in the model, and the finding is a test exactly distributed as chi-square. The null hypothesis for the test of variance homogeneity was conducted. The hypothesis will reject if the *p*-value exceeds 0.05 and the alternative hypothesis will be accepted, which means that the variance is heteroskedastic. The following table presents the findings of both tests and the significance of chi2 shows that there is no heteroskedasticity problem.

Table 5.22
White and Breusch-Pagan Tests for Heteroskedasticity

	White test	**Breusch-Pagan test**
chi2(1)	131.87	1.09
Prob > chi2	0.4135	0.2961

5.4.3.1.4 Multicollinearity

Multicollinearity is the inter-correlation of the independent variables. Multicollinearity poses a problem when a number of explanatory variables are employed. As a consequence, the effect of each of the independent variables on the dependent variables becomes difficult to identify (Naser, 1998; Naser & Al-Khatib, 2000).

There are two steps to test multicollinearity. First, the inter-correlation matrix (r) for the bivariate analyses between the independent variables needs to be examined. The r should not be more than 0.80 or 0.90 (Judge *et al*., 1985; Bryman & Cramer, 1999; Gujarati, 1995). If the correlation is more than 0.90, the next step is to look at the variance inflation factor (VIF).

Table 5.23
The Values of VIF

Variables	VIF
MUSP	2.039
NEBOD	1.315
SCEO	4.506
CHAIRP	4.660
SSB	4.006
NSSB	1.316
CROSS	2.268
PHD	1.849
REP	3.508
AC	3.105
NAC	2.417
ACACC	1.442
NEAC	2.220
PERFOR	1.474

When the VIF is higher than 10 the multicollinearity will be a serious problem (Haniffa & Cooke, 2005; Naser *et al*., 2006; Kennedy, 1992). If the multicollinearity is existed, there is one way to solve this problem that is by dropping one of the variables.

As shown in Table 5.23, all values of VIF are lower than 5. So, these values of VIF indicate that there is no serious problem of multicollinearity.

5.4.3.1.5 Outliers

Outliers are cases whose extreme values substantially vary from the other cases. To test outliers, a number of methods are available. Standardized residuals' method is used, which a widely used to examine the existence of any outliers. According to Tabachnick and Fidell (2007), outliers are a serious problem when the cases have a standardized residual of more than +3.3 or less than -3.3. When outliers existed, the decision to delete or modify the outliers should be made carefully. Without doubt, deleting the outliers from the data set would improve the results but it may be generating further outliers in the observations. Accordingly, before removing the outliers, multiple regression should be run to show whether there are variations in the estimated coefficients. If there is no important diversity, no outliers are removed from the data (Kamardin, 2010).

5.4.3.2 Results of Regression Analysis

Table 5.24 reports the findings of the first model using the approach of normal scores for different transformation of the dependent and independent variables to produce the best fit. The adjusted R^2 was 0.475, which is greater than 0.393 and 0.240 as found in the study of Farook *et al*. (2011) and Bukair and Abdul Rahman (2011), showing that the model explains a significant amount of CSR disclosure difference for explanatory variables. Surprisingly, the results reveal that the MUSP factor is insignificant in the opposite predicted direction, which is inconsistent with previous studies (Farook & Lanis, 2005; Farook *et al*., 2011). This finding suggests that the proportion of Muslim population is not an important determinant to enforce and pressure on the Islamic banks to disclose CSR information. This result rejected H1, which showed that there is a positive association between proportion of Muslim population and CSR disclosure by the banks. The explanation behind that, the size of the relative public proxy played a limited role to influence the policy and practice of CSR disclosure. Furthermore, from the Islamic perspective, there is no reason why a country with a great population would necessarily have banks that provide more information of corporate social responsibility than a country with a lower population, since all Islamic banks must comply with *Shariah* principles and rules.

Regarding corporate governance mechanisms, the results found a negative significant relationship between the position of the board of directors and CSR disclosure, and it does not support H_2 of the study. This implies that Islamic banks with boards having fewer non-executive directors tended to disclose more CSR information. This result is in line with the findings of earlier studies in the area of voluntary disclosure (Barako *et al*., 2006; Gul & Leung, 2004; Haniffa & Cooke, 2005). The important implication of this result is that an increase in non-executive directors decreases CSR disclosure. As a result, these findings indicate that higher monitoring by independent non-executive directors leads to lower disclosure level of CSR because actually, their effectiveness is like a monitoring mechanism as many of them are appointed by the CEO or the board chairperson (Ho & Wong, 2001). However, the findings do not support H_3 and H_4 of the separation role of the CEO and the chairperson and the chairman's position respectively, which is not significantly related to CSR disclosure. The result of separation function of the CEO and the chairman is consistent with the studies of Barako *et al*. (2006), Eng and Mak (2003), Haniffa and Cooke (2002), Ho and Wong (2001), Li *et al*. (2008) and Said *et al*. (2009). A possible explanation behind that is that a person who acts both the roles of the chairman and the CEO of an Islamic bank is likely to be a shareholder; hence it is not a problem, whether or not the two functions are separated, which is in line with the stewardship theory. Furthermore, the role duality allows the CEO to manage the company in achieving its objectives and enhancing the leadership in a bank (Dahya *et al.*, 1996). The finding of the position of the chairman is in line with the study of Ho and Wong (2001) and Wan-Mohamad and Sulong (2010) who found insignificant direct relationship. This reflects that a non-executive chairman does not have more power to influence CSR disclosure. This result contradicted with the agency theory which documents that the chairman as a non-executive director in the company can play a greater independent function in improving the disclosure.

In terms of the *Shariah* supervisory board, only the variable SSB with cross-memberships has a high statistical significant association with CSR disclosure. This result supported H_7 and is in line with the study by Farook and Lanis (2005), who found the factor of CROSS has a significant direct effect on CSR disclosure. In contrast, the existence of SSB, the size of SSB, the SSB members with PhD qualifications, and the SSB members who have at least one position in the AAOIFI board are found to be not significantly associated with CSR disclosure. Therefore, H_5, H_6, H_8 and H_9 are not supported. One possible reason behind these findings would be that, the SSB and its attributes separately play a limited role to influence CSR disclosure except for the cross-memberships of SSB. This seems to confirm that the SSB members with knowledge and experience obtained by working in more than one board would be able to impact CSR disclosure, and this result is consistent with the earlier studies (Haniffa & Cooke, 2005). This finding should become an important contribution for the policy makers to put new guidelines which are correlated with corporate governance.

Concerning the audit quality, the findings indicate positively significant association at the 10% level, as predicted, between CSR disclosure and an audit committee's boards dominated by boards having an accounting or finance certifications (ACACC) and non-executive directors (NEAC). The results also show a positive significant relationship with audit committee's meetings (MEET) but at the level of 5%. The results of ACACC, NEAC and MEET are consistent with other studies (Kelton & Yang, 2008), and it supported H_{12}, H_{13} and H_{14}. The evidence of these results suggests that Islamic banks with audit committee's boards having financial expertise tend to disclose more information about CSR. The finding of the NEAC variable proposes that audit committee's boards which are controlled by the non-executive directors may have the ability to influence the policy of the banks in CSR disclosure practice. This is because the basis of extensive knowledge and experience of non-executive directors and also, in some cases, because there is a variation in the societal concerns. In terms of the audit committee's meetings, the board of an audit committee that has regular meetings would have more knowledge and has the ability to resolve related accounting and auditing problems (Abbott *et al*., 2003). Given that the board of an audit committee with more non-executive directors, more different experiences and skills and frequent meetings will perform monitoring effectively. More important is that the results should become a significant effort for the authorities to develop the guidelines regarding corporate governance.

However, the other hypotheses are not supported (H_{10}, H_{11} and H_{15}). The results show insignificant relationship between CSR disclosure and the existence of the audit committee but in the opposite direction, which is unexpected. This result is consistent with Gul and Leung (2004). Thus, Islamic banks with an audit committee are expected to have a lower extent of CSR disclosure. The coefficient on the number of an audit committee is negative but insignificant at the conventional level. This result indicates that the number of an audit committee leads to the lower disclosure of CSR, and it is consistent with the study of Akhtaruddin *et al*. (2009). The possible reason is that the higher the number of SSB and AC (higher monitoring) prevent Islamic banks from disclosing something they do not practice. In terms of audit type (AUDIT), the coefficient shows a positive but not significant association with CSR disclosure, showing that the audit Big-Four firms have little or no influence on the Islamic banks to provide information regarding CSR in their annual reports. The finding is in line with Haniffa and Cooke (2002) and Akhtaruddin *et al*. (2009). These results show that the existence of the audit committee with independence, knowledge and experiences as well as regular meetings enhance the monitoring on the policy of CSR practices of an Islamic bank, and this is in line with the perspective of the resource independent theory (Pierce & Zahra, 1992).

The model indicates that bank size (BSIZE) is statistically positively significant with CSR disclosure and is supported H_{17}, while financial performance (PERFOR) is insignificant in predicted direction, which is rejected H_{18}. Larger Islamic banks provide additional CSR disclosure to show their compliance with the principles of accountability and full disclosure since they have more resources such as human capital and greater investments. This result is in line with prior studies (Hamid, 2004; Haniffa and Cooke, 2005; Akhtaruddin *et al*., 2009; Othman *et al*., 2009). This reveals that the banks use annual reports as a channel to publicize their image and legitimize their social activities. The association between size and CSR disclosure supports the legitimacy theory (Patten, 1991; Gray *et al.*, 2001). The insignificance of PERFOR is consistent with Barako *et al*. (2006), Barako (2007), García-Ayuso and Larrinaga (2003), Cowen *et al*. (1987) and Hackston and Milne (1996) who found no relationship between profitability that was measured by return on equity and disclosure. The relationship does not support the legitimacy theory. This indicates that the decision to provide CSR information is not affected by the financial performance level.

Table 5.24
Results of OLS Regression for Model 1

Variables	Predicted Sign	Std. Coefficient	*T*	Sig.	VIF
Intercept			-1.619	0.108	
MUSP	+	0.031	0.323	0.747	2.039
NEBOD	+	-0.166	-2.140	0.035**	1.315
SCEO	+	0.091	.631	0.529	4.506
CHAIRP	+	0.199	1.361	0.176	4.660
SSB	+	0.113	0.832	0.407	4.006
NSSB	+	0.028	0.362	0.718	1.316
CROSS	+	0.314	3.072	0.003***	2.268
PHD	+	-0.043	-0.467	0.642	1.849
REP	+	0.046	0.358	0.721	3.508
AC	+	-0.064	-0.539	0.591	3.105
NAC	+	0.044	0.417	0.677	2.417
ACACC	+	0.143	1.760	0.081*	1.442
NEAC	+	0.180	1.777	0.078*	2.220
MEET	+	0.163	1.983	0.050**	1.474
AUDIT	+	0.055	0.697	0.487	1.334
BSIZE	+	0.223	2.672	0.009***	1.516
PERFOR	+	0.058	0.753	0.453	1.293
F Value	6.079				
Sig. F (p-value)	0.000				
R	0.690				
R^2	0.475				
Adjusted R^2	0.397				

***, **, * indicate two-tailed significance at $p < 0.01$, $p < 0.05$ and $p < 0.10$, respectively.

Diluted results are actually due to certain mandatory disclosure on CG mechanisms in which country Islamic banks operate. Each country has its own regulations and standards regarding CG, which are different from another country and Islamic banks must follow their requirements.

Table 5.25 presents the findings of the second model. The findings showed that only the *Shariah* supervisory board's effectiveness (SSBE) and audit quality (AUDITQ) are statistically significant at the 1% level. For control variables, the findings revealed that both the bank size (BSIZE) and financial performance (PERFOR) are significantly at the 1% and 5% level respectively.

Table 5.25
Results of OLS Regression for Model 2

Variables	Predicted Sign	Std. Coefficient	*T*	Sig.	VIF
Intercept			-5.599	.000**	
BODE	+	-0.035	-.460	.646	1.175
SSBE	+	0.366	5.020	.000**	1.090
AUDITQ	+	0.324	4.568	.000**	1.031
BSIZE	+	0.236	3.241	.002**	1.087
ROE	+	0.1161	2.169	.032*	1.125
F Value	15.740				
Sig. F (p-value)	0.000				
R	0.620				
R^2	0.384				
Adjusted R^2	0.360				

** and * indicate two-tailed significance at $p < 0.01$ and $p < 0.05$.

The R^2 of the model explains 38.4% of the variation of CSR disclosure, which is greater than 12.4% as that found in O'Sullivan *et al*. (2008). The result of SSBE is consistent with Farook *et al*. (2011) and Bukair and Abdul Rahman (2011), who found a highly significant association with CSR disclosure. The significance of SSBE suggests that the existence of SSB and its characteristics leads to more monitoring and therefore, to have more compliance with the *Shariah* principles, consequently, to greater disclosure level of CSR. The finding of AUDITQ is in line with the best practice of CG for IFIs, the recommendations from the Blue Ribbon Committee (1999), and O'Sullivan *et al*. (2008) who report an association between the audit quality and the disclosure of forward-looking. These findings of AUDITQ indicate that a strong audit committee and its characteristics as well as the presence of the Big-Four firms will guide in order to improve the CSR disclosure practice. However, the result reveals that the board of directors' effectiveness is not correlated with CSR disclosure, indicating that the board has limited or no role to impact on the management to disclose information related to CSR in the annual reports of the Islamic banks. This result is consistent with prior studies (O'Sullivan *et al.*, 2008).

The third OLS regression incorporates the score measure of corporate governance and the two explanatory variables (see Table 5.26). The results show that CGSCORE is a highly statistically significant at less than the 1% level, which is supported H_{16}. This finding reveals that the strength of the Islamic bank's corporate governance structure is positively related to CSR disclosure. Hence, this suggests that an increase in the quality of corporate governance, it is more expected to lead to a high disclosure level of CSR. The findings are consistent with Willekens *et al*. (2004) and Chobpichien, Haron and Ibrahim (2008), who found that companies with the existence of good corporate governance publish more voluntary disclosure information. The results supported the hypothesis that a high quality of corporate governance can guide to enhance CSR disclosure that is used as a tool to reduce both information asymmetry and agency problems.

Moreover, the implementation of these corporate governance mechanisms as high standards will bring significant benefits to all Islamic banks through gaining a good reputation domestically and internationally. In addition, these principles will enhance transparency and managerial efficiency and consequently, supports the confidence of all stakeholders such as shareholders, employees and investors as well as other groups in the society.

Table 5.26
Results of OLS Regression for Model 3

Variables	Predicted Sign	Std. Coefficient	*T*	Sig.	VIF
Intercept			-5.211	.000**	
CGSCORE	+	.383	5.022	.000**	1.034
BSIZE	+	.306	4.010	.000**	1.038
ROE	+	.10	1.294	.198	1.072
F Value	16.739				
Sig. F (p-value)	0.000				
R	0.531				
R^2	0.282				
Adjusted R^2	0.265				

**, * indicate two-tailed significance at $p < 0.01$ and $p < 0.05$.

The control variable of BSIZE is significantly associated with the disclosure level of CSR at the 0%. This result indicates that larger Islamic banks decide to provide CSR information to reduce their political costs. The management may also tend to disclose CSR information to legitimize the continuance existence of the banks. However, the study found that PERFOR is not significantly correlated with CSR disclosure, and this finding is consistent with the view of Islam, which emphasize the firms that operate based on the principles and rules of *Shariah* should provide information regarding CSR irrespective of whether they achieve profits or otherwise. The R^2 shows that the model explains 28.2 % of the variations in the CSR disclosure, which is considered higher than 10% in O'Sullivan *et al*. (2008).

In the first model, the significance of the percentage of non-executive directors on the board of directors, the cross-memberships of SSB, the members of an audit committee with accounting or finance certifications, the percentage of non-executive directors on the audit committee and the number of an audit committee's meetings may support the legitimacy theory. The highly positive significant relationship of the *Shariah* board's effectiveness and audit quality as well as the score of corporate governance in the second and third model may also support the perspective of the legitimacy theory.

Regarding control variables, the greater significant association of bank size in all the three models and bank performance in the second model are supported the legitimacy theory, and a large and profitable bank may motivate its management to provide information related to CSR. The legitimacy theory states that CSR disclosure is related to both public pressure and social visibility as a result from the main social activities (Brown & Deegan, 1998; Patten, 1991).

5.5 SUMMARY

This chapter aims to measure the proposed framework for determining the extent of CSR disclosure in the annual reports of Islamic banks. The study conducted statistical, correlations and regressions' tests, and the findings of those tests supported the framework of CSR disclosure in general.

The empirical findings show that banks which have the effectiveness of *Shariah* supervisory board, audit quality and a good system of corporate governance are likely expected to provide more CSR information to all groups of the stakeholders in the society, particularly the Islamic investors. Therefore, the disclosure level of CSR would be determined based on the Muslim population and the corporate governance mechanisms, including the attributes of the board of directors, the *Shariah* supervisory board's characteristics and audit quality.

The findings indicate that the board of directors' effectiveness has no relationship with the disclosure level of CSR, showing that the banks with the directors' board tended to disclose less information related to CSR. These results referred to the fact that the board of directors has, in most cases of Islamic banks, less or no impact on their banks to provide CSR information compared with the *Shariah* supervisory board.

The empirical findings of the study give clear evidence of prior studies regarding the influence of the governance system on CSR disclosure. These results are actually based on the function of corporate governance practices that makes Islamic banks have greater awareness of their social responsibilities among the communities. It seems that both the effectiveness of *Shariah* supervisory board and audit quality, as well as the overall measure of corporate governance practices had a great impact on CSR disclosure. Based on these findings, it can be argued that the legitimacy theory is the major appropriate theory to explain CSR disclosure practices by Islamic banks throughout the world. Hence, the banks provide CSR information in their annual reports to mitigate the public pressures.

CHAPTER SIX

CONCLUSION

6.1 INTRODUCTION

The recent three decades have witnessed the increasing attention given to the concept of corporate social responsibility (CSR) of a firm from different groups of stakeholders, which resulted in more disclosures for these activities. The extensive literature on CSR disclosure has been developed over the same period. The main objective of the study is to explain the determinants that may influence CSR disclosure through the framework of the research grounded from legitimacy theory. This study starts with a common discussion that legitimacy theory is the most acceptable theory to clarify the phenomenon of CSR disclosure. Derived from legitimacy theory, CSR disclosure for a company means that they are responsible to the pressures of public about its social duties. This study uses the legitimacy theoretical framework to examine the determinants of CSR disclosure based on prior studies. The previous studies suffered from two common limitations:

- Limitations regarding CSR disclosure: most of the earlier studies had focused on non-banking industries which left a gap in the literature, particularly in the Islamic financial sector. Concerning Islamic social reporting studies, the majority of these studies focused broadly on the extent and nature of CSR disclosure.

In addition, most of these studies used a zero/one approach to measure CSR disclosure rather than other methods with limited categories:

- Limitations regarding factors that influence CSR disclosure. There is no clear framework from prior studies in selecting the chosen variables and the results of relationships between corporate governance mechanisms and CSR disclosure are mixed and inconclusive.

The present study developed a theoretical framework to examine the determinants of CSR disclosure by using three empirical models. The first model examined the influence of the relevant public and governance mechanisms on CSR disclosure based on social pressure. The literature showed that the variable of relevant public was important in determining the awareness level in society concerning corporate social responsibility which indirectly influences the disclosure level of CSR. Previous studies indicated inconsistent relationships between governance factors and CSR disclosure. The second model examined the influence of the board of directors' effectiveness, the effectiveness of the *Shariah* supervisory board and the audit quality on CSR disclosure and prior studies revealed incongruous relationships. The effectiveness of both SSB and audit quality were the most important elements in determining the disclosure level of CSR. The third model examined the overall score for the governance system impact on CSR disclosure which was supposed to be a significant determinant of CSR disclosure as indicated by the literature.

These models contained a number of variables and the most important variable is CSR disclosure, which is captured from the annual reports. The study used content analysis to measure CSR disclosure in the annual reports. OLS regression was used to statistically examine the models and the next section presents a summary of the results and conclusions.

6.2 SUMMARY OF THE RESULTS AND IMPLICATIONS

The current study examined the level of CSR disclosure in the annual reports of Islamic banks. It also examined the influence of three groups of factors: relevant public, corporate governance, and company characteristics as control variables based on legitimacy theory. To achieve the objectives of the research, content analysis was used to measure CSR disclosure, as a technique widely adopted in prior studies. The descriptive statistics of the study indicated significant differences in levels and types of CSR disclosure due to the data being cross-sectional. Generally, all banks in the sample disclosed some form of CSR information in their annual reports. The banks also provided reasonable amount of information related to various themes of CSR. The results showed that the top management was the highest theme disclosed followed by products and services, while the environment was the lowest. This is because the banking sector has a small impact on activities regarding environment compared with other industrial sectors (Simpson & Kohers, 2002; Branco & Rodrigues, 2008a). Consistent with the legitimacy assumption on strategy and threat (Lindblom 1994; Patten, 1991), it is supposed that the greatest disclosure theme of top management and products and services may affect the perceptions of the public on the bank's performance. More importantly, the highest disclosure generates great confidence among investors and general public to put their deposits in the banks.

OLS regression was employed to show changeability in the dependent variable with the independent variables of relevant public and corporate governance with firm-specific elements used as control variables. The study found that five of the governance factors as well as one of the control variables were significant enough to clarify the changeability in CSR disclosure practice of Islamic banks in 2008 for the first model.

The negative significant correlation between non-executive directors and CSR disclosure indicated that the higher monitoring by NEDs leads to lower disclosure levels of CSR. This is because many of them were actually appointed by the CEO or the chairperson (Ho & Wong, 2001). In other words, executive directors who are aware of the environment of the business, make disclosure decisions to achieve financial objectives. Therefore, the banks can use CSR disclosure as a legitimizing policy to reduce the society pressure. The significant association between cross-memberships of SSB (CROSS) and CSR disclosure indicated that the members of SSB with additional knowledge and experience through their representation in more than one board may encourage banks to participate in CSR disclosure to legitimize their policies to show their social values and to make sure that the bank is in compliance with societal issues according to the Islamic *Shariah.*

The results of the study showed a positive significant relationship at a 10% confidence level between audit committee boards dominated by boards having accounting or finance certifications (ACACC) and non-executive directors (NEAC) as well as committee meetings (MEET) at the 5% confidence level with CSR disclosure. The findings showed that the board of the audit committee with more non-executive directors, more different experiences and skills and frequent meetings performs monitoring more effectively. The high significance of bank size supports legitimacy theory. Moreover, the result of financial performance was in line with the view that the decision to provide social information is due to public pressure rather than to achieve profitability (Patten, 1991). This finding confirms the basic concept of legitimacy theory that perceives CSR disclosure as a tool used by banks to legitimize their business activities.

These results had direct implications for the *Shariah* supervisory board (SSB) of Islamic banks and authorities. An SSB that aims to enhance the quality of CSR disclosure may need to incorporate the significant findings regarding the SSB with members who represent in more than one board as the requirements for becoming board member. Furthermore, the audit committee members should have an accounting or finance background or experience; and they should be non-executive directors as well as maintaining a sufficient meeting frequency. To improve the quality of CSR disclosure, the authorities of Islamic banks should provide good practice guidelines related to an audit committee size of more than three non-executive directors with accounting or finance qualifications and at least four meetings per year, as well as having a SSB member working on more than one board.

The findings of the OLS regression for the second model revealed that both effectiveness of SSB and audit quality were significant and positively correlated with the decision to provide CSR information in the annual reports of Islamic banks. On the other hand, there was no relationship between board of directors' effectiveness and CSR disclosure practice. The significance of the corporate governance factors supports the view that Islamic banks may be driven by economic incentives. In particular, the size of the *Shariah* supervisory board (SSB) with more cross-memberships, doctorate qualifications and international reputation results in higher monitoring, more conformity with *Shariah* principles and rules and greater disclosure levels of CSR. This means that board members with sufficient experience and skills are responsible for understanding the purposes of the *Shariah* and practicing it in modern financial institutions by disclosing more CSR information. Furthermore, the significance of the audit quality (AUDITQ) implies that an audit committee which has more members having an accounting or finance experience, non-executive directors and having sufficient meeting frequency and whose financial statements were audited by Big-Four firms lead to improve controlling, greater compliance with the *Shariah* and disclosing more information regarding CSR. In addition, the importance of both SSB and AUDITQ in influencing the level of CSR disclosure means that the Islamic banks provide CSR information in the annual reports to bond their ties with the investors. Moreover, the significance of findings of both bank size and financial performance were supported by legitimacy theory. These results are in line with the concept of legitimacy theory that CSR disclosure is the bank's legitimizing instrument to maintain public pressure and economic benefits.

The results of the OLS regression for the third model showed that the overall corporate governance score has a high significant correlation with the disclosure level of CSR. The importance of this relationship is that the strength of the bank's governance framework may be influenced by the effectiveness of each of the board of directors, the *Shariah* board, and the audit quality, and hence the higher disclosure and greater monitoring are based on this strength. Furthermore, the significance of the bank size tends to support the view of legitimacy theory that CSR disclosure may be influenced by the pressure from stakeholders' groups rather than financial performance (Patten, 1991).

Overall, the findings suggest that there are several elements that influence the disclosure level of CSR by Islamic banks. These factors include economic motivations and public pressure. The findings have a number of potential policy implications for policy makers and regulators.

First, these results give empirical evidence to both policy makers and regulators that the whole governance system is consistent with CSR disclosure and they indicate that by having corporate governance guidelines, they can enhance a bank’s disclosure and transparency within the annual reports. The importance of these results is that investors continuously use the annual reports as their main sources of information. Further, regulators are encouraging Islamic banks to use their annual reports for disclosure objectives.

Second, the effectiveness of the SSB improves the monitoring level among the banks and hence leads to a higher CSR disclosure. The significance of these findings suggest that the banks need to invest more on training and educating members of the SSB to increase the confidence of investors and the community at large (Bakar, 2002).

Third, the audit quality effectiveness leads to improve the monitoring function of an audit committee, and consequently, the disclosure level of CSR. In addition, the quality of auditor type (Big-Four) enhances the level of both control and disclosure. The significance of these results is important for users of annual reports due to their increasing confidence in such disclosures. Moreover, these findings also suggest that having a uniform accounting standards and implementing *Shariah* principles and rules throughout the world would lead to more uniform disclosure level by Islamic banks (Dudley, 2004; Karim, 2001).

6.3 LIMITATIONS

The current study has a number of limitations like any other research in the area of CSR disclosure when interpreting the results. First, it only used one year (2008) to identify the types and the extent of CSR information published in the annual reports of Islamic banks. Second, the study used CSR disclosure without differentiating between voluntary and mandatory disclosure. Third, the index of CSR is very sensitive and can influence the findings if the selected items of information are incorrect. Fourth, this study focused on the annual reports to measure CSR disclosure without considering other disclosure media. Fifth, there are limitations related to variables that were used in this study. The study does not investigate all the potential factors that may affect CSR disclosure. Finally, it only used legitimacy theory from an Islamic perspective and neglected other theories that are also used to interpret social and environmental disclosure.

6.4 RECOMMENDATIONS FOR FUTURE RESEARCH

There are a number of recommendations for further research. Future research can generalize these findings by analysing the effect of other corporate governance mechanisms on CSR disclosure. It is important to study the relationship between governance factors and CSR disclosure in distinct environments. This is because governance practices may vary due to different environments. Researchers can also conduct comparative studies in various countries to examine the association between governance elements and CSR disclosure. Future research may also measure the trends of CSR disclosure and the governance quality using longitudinal data to witness the change in CSR disclosure over time. This point is consistent with Farook *et al*. (2011) who reported lower information of disclosure items for 2007 in selected Islamic banks. Additional studies may use other types of media to communicate with investors and different groups of stakeholders in the society such as banks websites, press releases and stand-alone reports rather than annual reports. Extending this study into another sector would show interesting findings in terms of variations within the industrial sectors. Within the framework of this study, it can examine the influence of other determinants not theorized in the present study such as governance ownership and competitiveness on CSR disclosure. For example, it is expected that banks with a great level of competitiveness due to social pressure may disclose more CSR disclosure.

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APPENDIX

Appendix A

CSR DISCLOSURE INSTRUMENT

Name of Bank: **Country:**

Text disclosures	Items	Themes
1- Vision and mission statement • Commitments in operating within *Shariah* principles • Commitments to achieve *Baraka* (blessing) and *al-Falah* (successful in the world and the hereafter) • Focus on maximising the returns of shareholders • Serving the needs of Muslim community • Offering efficient service to consumer • Emphasizing on the importance of permissible (halal) profit • Commitments to engage in investment activities that comply with *Shariah* principles • Commitments to engage in financing activities that comply with *Shariah* principles		
2- Top management • Details of names and profile of BOD and management team • Details regarding the qualifications of BOD and management team • Statement on remuneration of BOD and management team • Statement on policy in appointing, re-appointment and dismissal of BOD and management team		
3- *Shariah* supervisory board (SSB) • Details regarding the qualifications of Profile of SSB • Details regarding the members of SSB • Statement on remuneration of the SSB members • Statement certifying distribution of profits and losses are made according to the Islamic *Shariah* • Statement of recommendations to rectify defects in products • The opinion of SSB regarding the bank's operation • Number of meeting held		
4- Unlawful (*haram*) transactions • Nature of unlawful transactions • Reasons for undertaking such transactions • The *Shariah* Board's 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		
5- Zakah **5. 1 *Zakah* (for banks required to pay it)** • Statement of sources and uses of *Zakah* • Statement showing the amount of *Zakah* paid and its computation • The balance of the *Zakah* fund, and reasons for non-distribution • *Shariah* Board attestation regarding the computation and distribution of the funds **5.2 *Zakah* (for banks not required to pay it)** • The amount due in respect of shares and deposits • The *Shari'a* Board's opinion regarding validity of computation		
6- *Quard Hassan* • Sources of funds allocated to *Quard* • The amounts given to beneficiaries • The social purposes for which the funds were given • The policy of the bank in providing such loans • The policy of dealing with insolvent beneficiaries		
7- Charitable and social activities • Sources and uses of charity • The nature of charitable and social activities financed • The amount spent on these activities • The sources of funds used to finance these activities		
8- Employees • Employees appreciation • Number of employees • The policy on wages and other remuneration • The policy on education and training of employees • The policy of equal opportunities towards women and minorities • Working environment • Statement detailing the company's policy on employees' welfare and benefit such as religious provision, holidays and medical benefits		
9- Late repayments and insolvent clients • The policy in dealing with insolvent clients • The amount charged as late penalty, if any • The policy on late payments by clients • The *Shariah* Board's opinion regarding the permissibility of imposing additional charges (such as late penalties)		
10- Environment • Finance any projects that may lead to environmental harm • Finance any projects that are user friendly to environment		

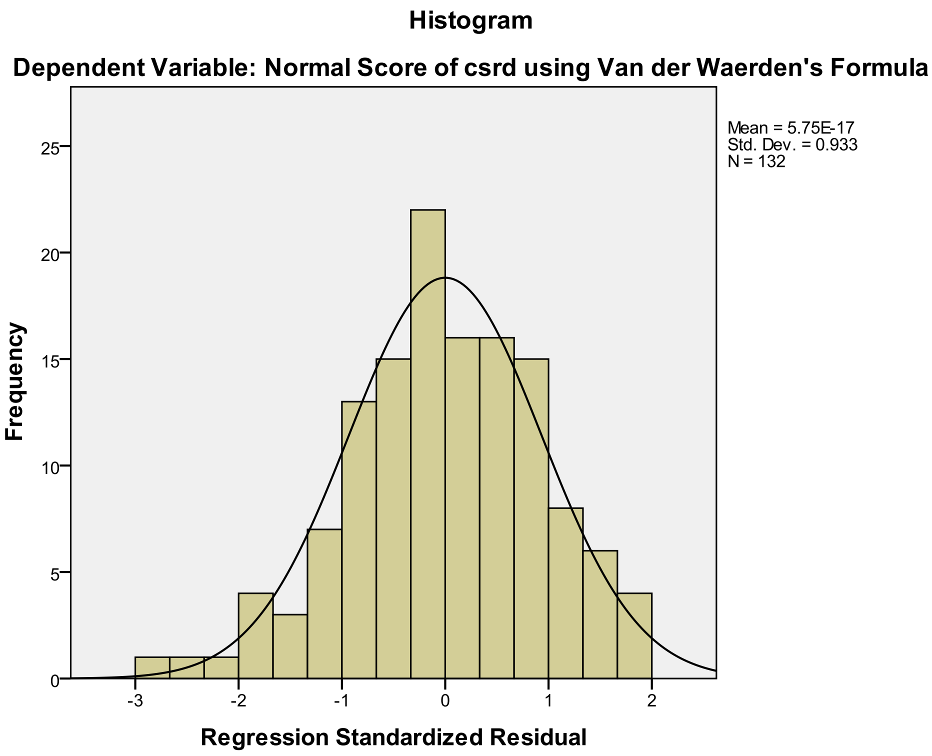
• Conversation of energy in the conduct of business operations • Amount spend on conversation of natural environment and wildlife • The company's operations are in line with environmental laws and regulation		
11- Products and services • Offering products and services based on *Shariah* principles • Statement stating all products/services are approved by SSB • Description regarding the basis of S*hariah* concepts for each product/service • Policy on marketing is in compliance with Islamic ethical values • Approved new products by SSB • Launching new products and services • Integrating and diversity of products and services		
12- Customer • Customer service • Meeting customer needs • Customer satisfaction		
13- Poverty • Poverty eradication • Constructing affordable and safety housing • Supporting small business • Supporting home-handy work • Employment of disabled • Creating jobs		
14- Other aspects of community involvement • Statement on contributions made to support acts by other organizations for the betterment of the society • The bank's role in economic and social development • Sponsoring Islamic educational and social events • Description of company's participation in government social activities		
Total (number of sentences)		

APPENDIX B

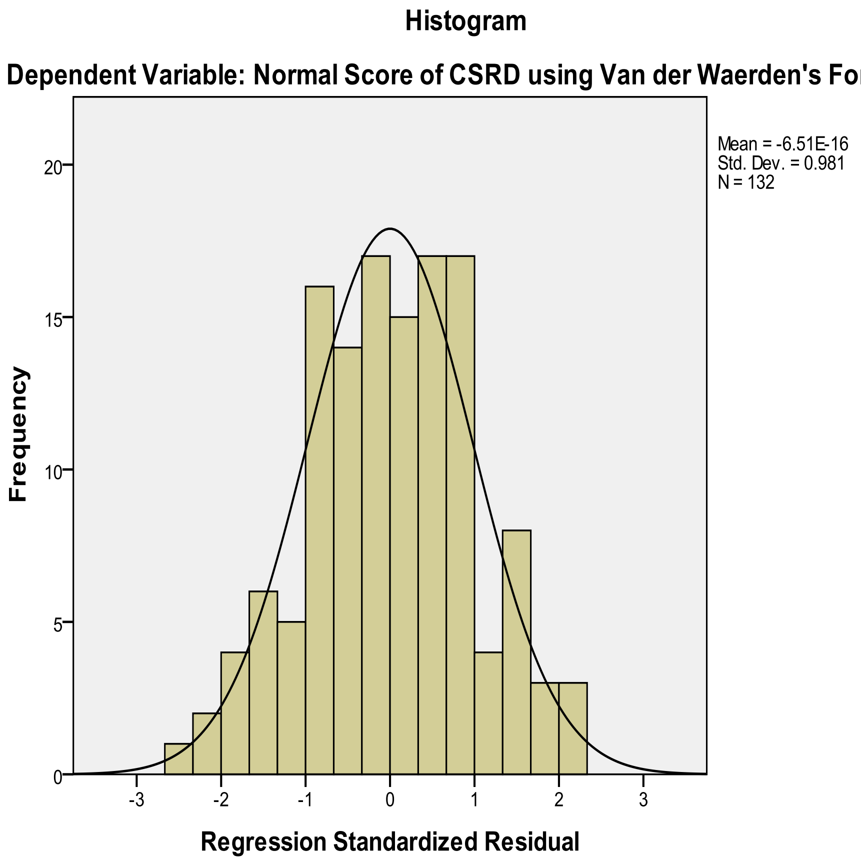
NORMALITY

Normality Histogram for the Three Models

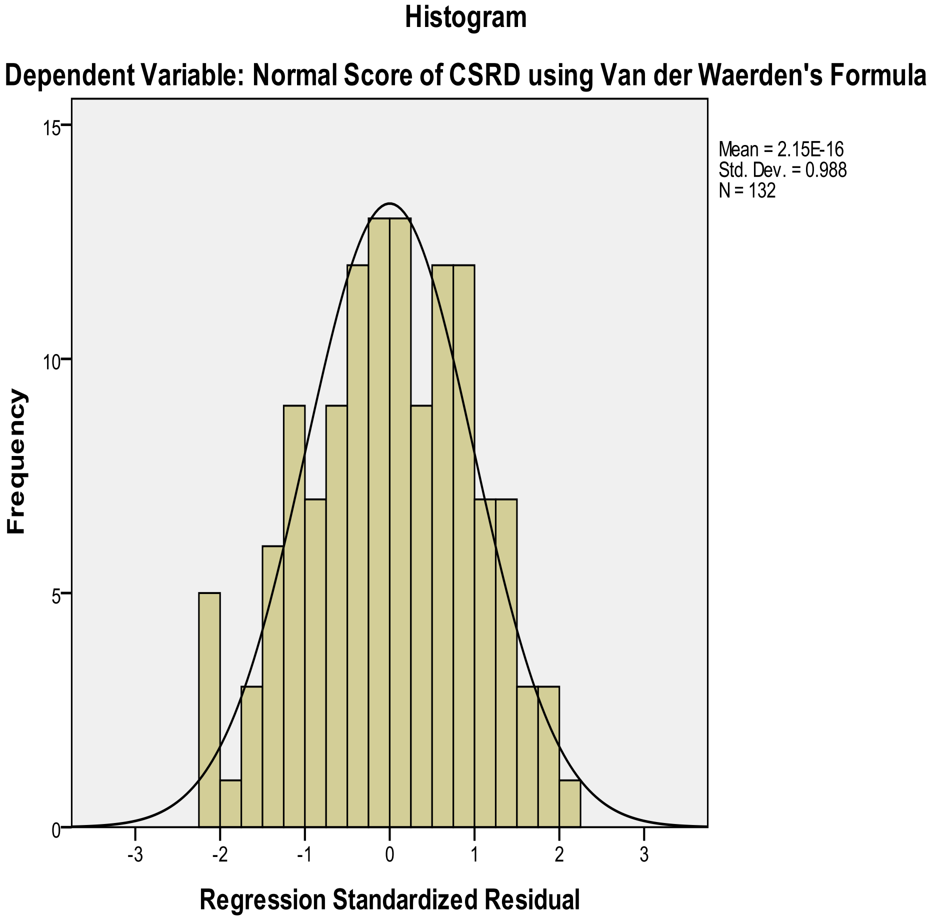
Histogram for Model 1



Histogram for Model 2

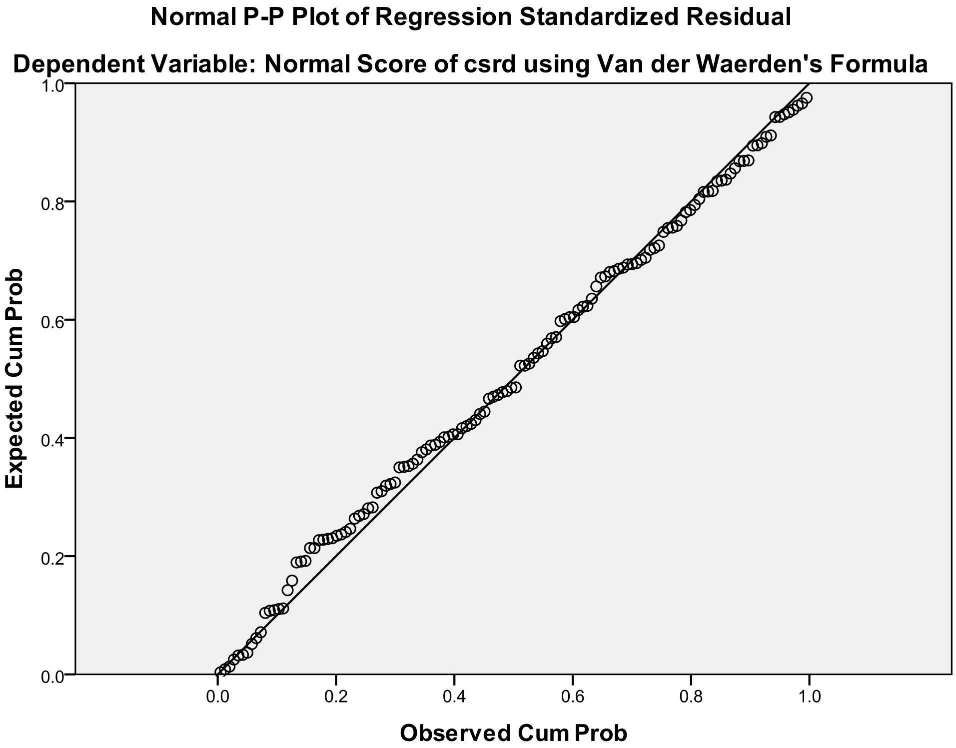


Histogram for Model 3

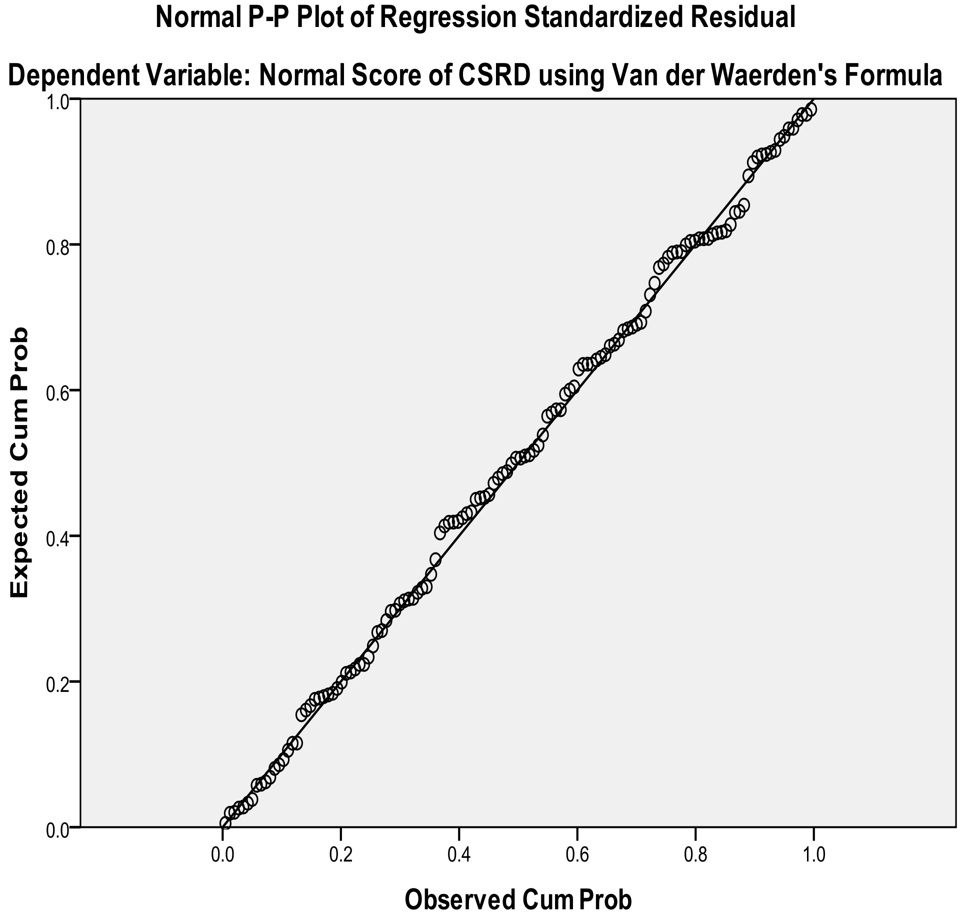


Normal PP Plot of Regression Standardized Residual CSRD for the Three Models

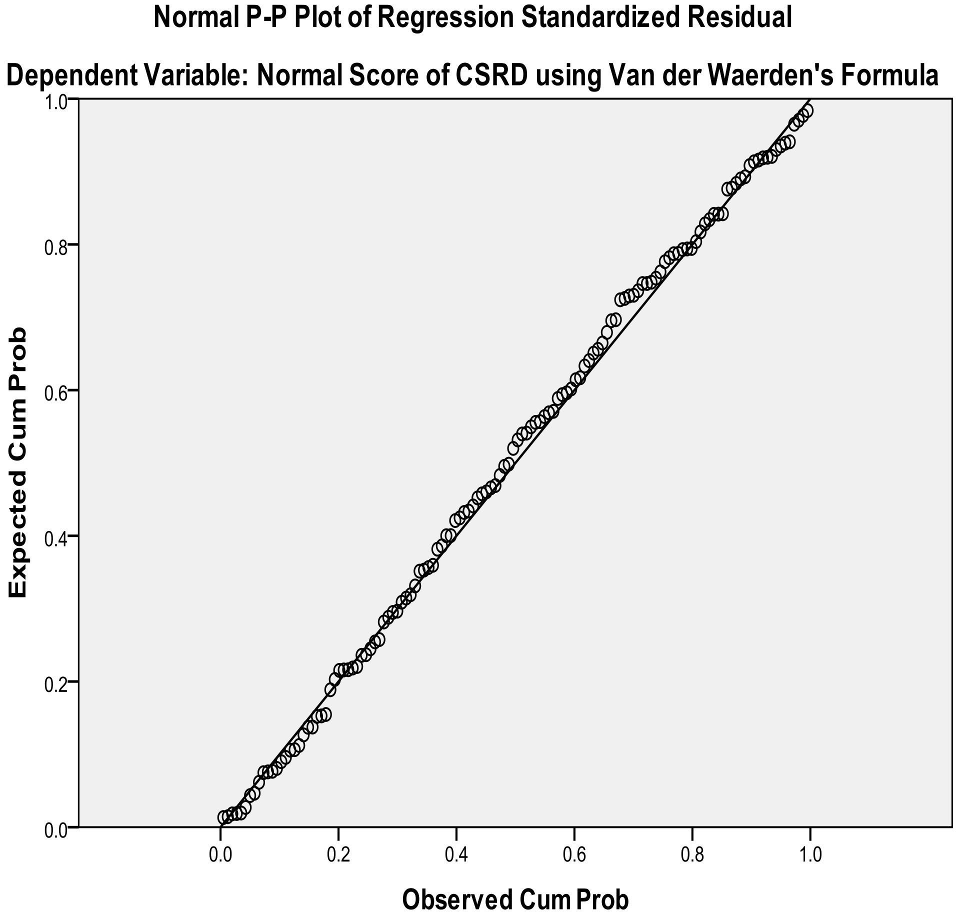
PP Plot for Model 1



PP Plot for Model 2

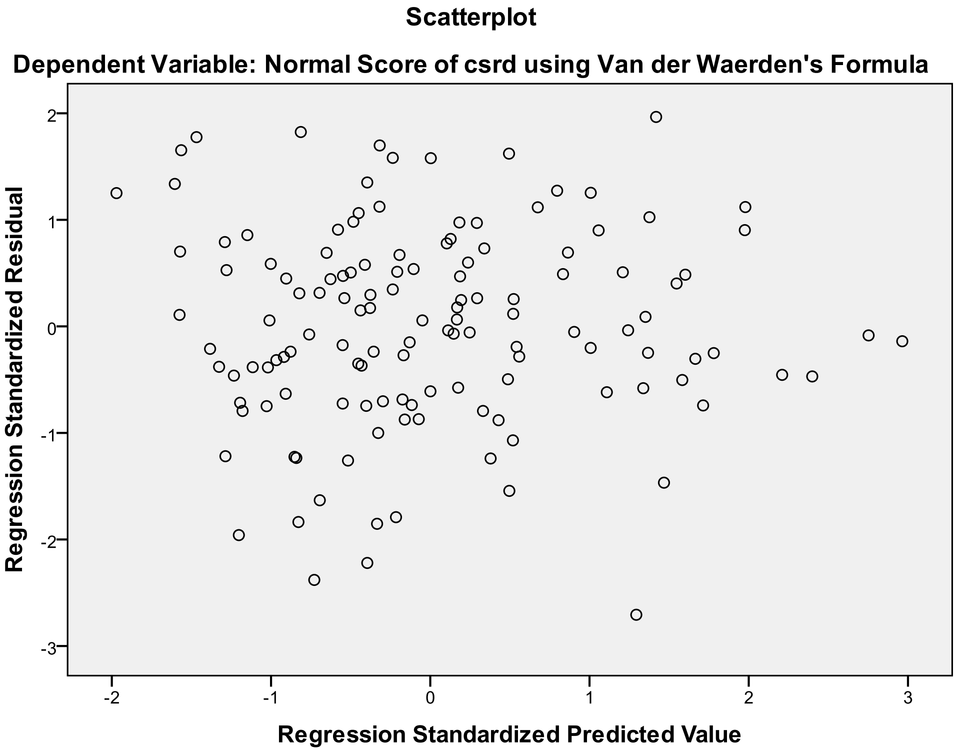


PP Plot for Model 3



Appendix C

Heteroscedasticity



Appendix D

ORDINARY LEAST SQUARE (OLS) REGRESSION RESULTS

Model 1

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.690[a]	.475	.397	.7537404	1.883

a. Predictors: (Constant), ROE, Normal Score of musp using Van der Waerden's Formula, Normal Score of meet using Van der Waerden's Formula, Normal Score of nebod using Van der Waerden's Formula, ac, audit, nssb, rep, dual, acacc, Normal Score of BSIZE using Van der Waerden's Formula, phd, Normal Score of neac using Van der Waerden's Formula, cross, Normal Score of nac using Van der Waerden's Formula, ssb, chairp

b. Dependent Variable: Normal Score of csrd using Van der Waerden's Formula

ANOVAb

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	58.712	17	3.454	6.079	.000[a]
	Residual	64.766	114	.568		
	Total	123.478	131			

a. Predictors: (Constant), ROE, Normal Score of musp using Van der Waerden's Formula, Normal Score of meet using Van der Waerden's Formula, Normal Score of nebod using Van der Waerden's Formula, ac, audit, nssb, rep, dual, acacc, Normal Score of BSIZE using Van der Waerden's Formula, phd, Normal Score of neac using Van der Waerden's Formula, cross, Normal Score of nac using Van der Waerden's Formula, ssb, chairp

b. Dependent Variable: Normal Score of csrd using Van der Waerden's Formula

Coefficients[a]

Variables	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-.886	.547		-1.619	.108
Normal Score of MUSP using Van der Waerden's Formula	.032	.099	.031	.323	.747
Normal Score of NEBOD using Van der Waerden's Formula	-.180	.084	-.166	-2.140	.035
SCEO	.250	.397	.091	.631	.529
CHAIRP	.517	.380	.199	1.361	.176
SSB	.264	.317	.113	.832	.407
NSSB	.061	.169	.028	.362	.718
CROSS	.724	.236	.314	3.072	.003
REP	-.121	.260	-.043	-.467	.642
PHD	.101	.281	.046	.358	.721
AC	-.235	.437	-.064	-.539	.591
Normal Score of NAC using Van der Waerden's Formula	.053	.128	.044	.417	.677
ACACC	.360	.204	.143	1.760	.081
Normal Score of NEAC using Van der Waerden's Formula	.263	.148	.180	1.777	.078
Normal Score of MEET using Van der Waerden's Formula	.173	.087	.163	1.983	.050
AUDIT	.121	.173	.055	.697	.487
Normal Score of BSIZE using Van der Waerden's Formula	.223	.083	.223	2.672	.009
PERFOR	.004	.006	.058	.753	.453

a. Dependent Variable: Normal Score of csrd using Van der Waerden's Formula

Model 2

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.620[a]	.384	.360	.7766723	1.759

a. Predictors: (Constant), PERFOR, ESSB, AUDITQ, Normal Score of BSIZE using Van der Waerden's Formula, BODE
b. Dependent Variable: Normal Score of CSRD using Van der Waerden's Formula

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	47.472	5	9.494	15.740	.000[a]
	Residual	76.006	126	.603		
	Total	123.478	131			

a. Predictors: (Constant), PERFOR, ESSB, AUDITQ, Normal Score of BSIZE using Van der Waerden's Formula, BODE
b. Dependent Variable: Normal Score of CSRD using Van der Waerden's Formula

Coefficients[a]

Variables	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-1.688	.301		-5.599	.000
BODE	-.110	.238	-.035	-.460	.646
ESSB	1.283	.256	.366	5.020	.000
AUDITQ	1.561	.342	.324	4.568	.000
Normal Score of BSIZE using Van der Waerden's Formula	.236	.073	.236	3.241	.002
PERFOR	.012	.006	.161	2.169	.032

a. Dependent Variable: Normal Score of CSRD using Van der Waerden's Formula

Model 3

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.531[a]	.282	.265	.8323760	1.547

a. Predictors: (Constant), PERFOR, GCSCORE, Normal Score of BSIZE using Van der Waerden's Formula
b. Dependent Variable: Normal Score of CSRD using Van der Waerden's Formula

ANOVAb

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	34.793	3	11.598	16.739	.000[a]
	Residual	88.685	128	.693		
	Total	123.478	131			

a. Predictors: (Constant), PERFOR, GCSCORE, Normal Score of BSIZE using Van der Waerden's Formula
b. Dependent Variable: Normal Score of CSRD using Van der Waerden's Formula

Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	-1.441	.276		-5.211	.000
GCSCORE	2.161	.430	.383	5.022	.000
Normal Score of BSIZE using Van der Waerden's Formula	.306	.076	.306	4.010	.000
PERFOR	.008	.006	.100	1.294	.198

a. Dependent Variable: Normal Score of CSRD using Van der Waerden's Formula