

# Exploring the Environmental Reporting Practices of Islamic Banks: A Case of Malaysia and Indonesia

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## Abstract

This study aims to explore the specific CSR practices i.e. the dimension of environment from an Islamic perspective. The three key principles in Islam, which comprise of vicegerent (*khalifah*), divine accountability, and obligation to enjoin good and forbid evil guide the understanding of business organizations' engagement to care for the natural environment. Annual reports (2007-2011) of six full-fledged Islamic banks in Malaysia and Indonesia have been analysed via content analysis method. The environmental information reported has been collected using a combined index developed from the AAOIFI's (2005) guidelines and significant prevailing literature. It is found that despite the indication of preserving the environment through banks' business activities, the environmental reporting practices of all the banks in both countries are yet to improve. The study offers insights pertaining to the influence of religion i.e. Islam on the extent of environmental reporting practice.

**Keywords:** environmental reporting, Islamic bank, annual report, Malaysia, Indonesia

## 1. Introduction

The acts of nurturing and conserving the natural environment are rooted in the Islamic law and principles, as contained within the Qur'an and the Sunnah of the Prophet Muhammad (pbuh). As Islam (2004) highlights that nature is indeed a gift from God for all humanity and all other living organisms live on in the Earth. The Quran provides a clear indication in this respect:

And He has made subservient to you, (as a gift) from Himself, all that is in the heavens and on earth: in this, behold, there are messages indeed for people who think! (45:13)

Human being as well as business organizations especially with Islamic status, such as Islamic banks are therefore highly expected to practice environmentally. Islamic banks are highly deemed to poses ethical identity, especially with the establishment built upon religious foundations.

In Malaysia, the initiative to promote greater environmental practice amongst public listed companies is evident through the introduction of the Corporate Social Responsibility (CSR) Framework by Bursa Malaysia in 2006. The framework requires all companies to report information on four key dimensions of CSR; which are marketplace, workplace, community and environment. Such a national effort has led to the increasing societal demand for businesses to act responsibly, including preserving the natural environment.

While many research studies have focused on the environmental reporting practice from the conventional perspective (e.g. Clarkson, Li, Richardson and Vasvari, 2011; Yusoff and Lehman, 2008; Sumiani, Haslinda and Lehman, 2007; Deegan and Rankin, 1996; Gray, Owen and Adams, 1996), some others have explored the reporting practice from an Islamic perspectives (e.g. Anuar, Sulaiman and Nik Ahmad, 2009; Othman and MdThani, 2010). This study therefore takes one step further by focusing on the Islamic environmental-related practice of business organization with full Islamic status. As a religion is a crucial aspect of a particular culture in which it puts great effects on the life of its follower (see Ousama and Fatima, 2010), this study aims to understand about the extent of application of the Islamic principles and law on Islamic businesses.

This paper is organized into four sections. The subsequent section proceeds with the background literature review of the study. The third section provides the methodology and this is followed by the results and discussion section. The final section offers the concluding comments.

## 2. Literature Review

### 2.1 Islam and the Concept of Social Responsibility

Islam acts beyond a religion and that it prescribes the way of life. The Qur'an and Sunnah govern the life of Muslims and provide clear guidance on both individuals as well as company's daily operations. Islam puts great emphasis on the need for Muslims to be accountable to Allah and the *ummah* (society at large) by recognizing the rights of others. In relation to CSR, the Qur'an describes that every human being is a trustee/custodian of Allah's resources. This is in line with the primary principle concerning the vicegerency role of humankind on Earth (*khalifah*) (see Farook, 2007). Islam also emphasizes the principle of divine accountability; this principle of which represents one's duty to uphold the values of fairness and justice in his/her daily practices. Guided by the concept of *tawhid* (the unity of Allah), all human beings are therefore subject to total submission to Allah's will according to the religious requirement in all aspects of life (see Maali, Casson and Napier, 2003). Generally, these two principles provide clear direction on the notion of enjoining good and forbidding evil. Accordingly, every Muslims as well as Islamic business organisations are expected to embrace good ethical values, and perform social responsibility and justice to society, including caring for the natural environment.

### 2.2 Islam and Social Responsibility-Environment

Ultimately, human beings are accountable to God additionally they are expected to act accordingly to other human being as well as care for the natural environment. Islam encourages the preservation of the natural environment as it is the crucial resource of life (see Salem, Hasnan and Osman, 2012). Moreover, the sustainable development of the environment is imperative for the future generations. The Qur'an emphasizes that everything on Earth are created for humankind. Apart from the Earth being considered as a gift to all, human beings have the responsibility to preserve it. Such an expectation works in tandem with the human being playing his/her role as the guardian of Allah's resources on it. Not only that we should act fairly and with justice to other human beings, but to other species and the natural environment. Hence, it is generally a test to measure man's act of worship in its broadest sense.

From a business perspective, environment is concerned with organizations' impacts on living and non-living natural systems, including ecosystems, land, air, and water. As the custodians of the Earth (*khalifah*), human being relationship with the natural environment is to make sure that the Earth that is loaned to us will sustain and survive indefinitely. Man has been entrusted with the duty to be responsible and accountable to Allah as the Giver and the representative of the human race and the natural environment. Hence, human being is expected to continue his/her day-to-day life and simultaneously protect as well as nurture the natural environment.

Allah sends down water from the sky and by it brings the dead earth back to life. There is certainly a Sign in that for people who hear. There is instruction for you in cattle. From the contents of their bellies, from between dung and blood, We give you pure milk to drink, easy for drinkers to swallow. And from the fruit of the date palm and the grapevine you derive both intoxicants and wholesome provision. There is certainly a Sign in that for people who use their intellect. Your Lord revealed to the bees: 'Build dwellings in the mountains and the trees, and also in the structures which men erect. Then eat from every kind of fruit and travel the paths of your Lord, which have been made easy for you to follow'. From inside them comes a drink of varying colours, containing healing for mankind. There is certainly a Sign in that for people who reflect. (16:65-69)

Islam also prohibits from any acts of destroying the Earth because such acts of destruction would result in an injustice to other claimants, which is contrary to the concept of the greater good.

...and when he goes away, he strives throughout the land to cause destruction therein and destroy crops and animals. And Allah (SWT) does not like mischievous acts. (2:205)

Islamic organisations have the obligation to uphold the value of accountability to mitigate and protect the natural environment from harmful effects as well as to preserve the natural environment in the ensuring sustainability of resources. Furthermore, the society (*ummah*) has the right to be informed about the effects of the operations of business organisation to others, including community and the natural environment. One opportunity to demonstrate responsibility and commitment in meeting the needs of the Muslim community in general is through the public disclosure of information that is relevant and reliable. Nevertheless, as cautioned by Anuar, Sulaiman and Nik Ahmad (2009), Islamic-based environmental reporting practice should not be used by companies as legitimisation act in gaining support from the society. Essentially, environmental reporting is a conscious business initiative towards fulfilling social accountability and transparency pertaining to disclosure actions (Baydoun and Willett, 2000; Sulaiman and Willett, 2003). These prevailing literature and the Islamic fundamentals has led to this study to explore and understand the current environmental-related practice by

Islamic businesses, which poses the question of whether religion play a significant role in motivating company's environmental reporting practice.

### 3. Methodology

The sample of this study comprised of all six full-fledged Islamic banks operating in Malaysia and Indonesia, as the followings:

Malaysia: Bank Islam Malaysia (BIMB), Bank Kerjasama Rakyat Malaysia (BKRM), Bank Muamalat Malaysia (BMMB)

Indonesia: Bank Muamalat Syariah (MMSB), Bank Mega Syariah (MGSB), Bank Mandiri Syariah (MDSB)

This study had used content analysis approach to examine the banks' annual reports of the period covering five years i.e. from 2007 – 2011; this which resulted to 30 cases of observation. The primary references for the information disclosure instrument used in this study include the *Accounting, Auditing and Governance Standards for Islamic Financial Institutions* (AAOIFI) guidelines (2005), Haniffa and Hudaib (2007), and Hasan and Harahap (2010). The eight sub-dimensions of the environmental aspects studied comprise of introduction of green product (GP), glossary/definition of green product (GD), investment for internal sustainable development programmes (IV), amount of donation in environmental awareness (DN), financing in any project which may lead to environmental damage (FN), investment in sustainable development projects (IS), initiatives to mitigate environmental impacts of product and services, and extent of impact mitigation (MT) and focus on risk-based corrective actions (RA). Below in Table 1 are brief explanations about the eight sub-dimensions/variables of environmental information studied.

Table 1. Scope of environmental information gathered

	Sub-dimension	Scope of information
1	Introduction of green product	Provides information about any specific 'green'-based product.
2	Glossary/definition of green product	Meaning and scope of 'green product' from the context of banks operation.
3	Investment for internal sustainable development programmes	Form of investment for programmes and activities internally in line with promoting sustainable development practices for the bank (e.g. recycling bin, energy-saving lights etc.).
4	Amount of donation in environmental awareness	Information on donations or other philanthropic activities reported in monetary value.
5	Financing in any project which may lead to environmental damage	Financing activities on high risk environmental-related projects/developments.
6	Investment in sustainable development projects	Investments made by the bank on green and sustainable development projects/developments.
7	Initiatives to mitigate environmental impacts of product and services, and extent of impact mitigation	Description on initiatives/efforts by the bank to lessen any negative impacts resulting from the products sold/services rendered.
8	Focus on risk-based corrective actions	Policy/procedure/plan/initiative on actions to be taken for any potential environmental-related risks.

The scoring of disclosure is done using an equal-weighted index, with a point awarded for each disclosure theme in relation to any of the key elements considered. Disclosure score for each bank is totalled and not given any specific percentage as it is considered that each item of disclosure is equally important. The environmental disclosure score indexes are constructed as follows:

$$\sum_{i=1}^{m_j} \frac{d_j}{N}$$

Where,  $N$  is the maximum number of relevant items a company may disclose and  $d_i$  is equal to 0 if there is no disclosure and score of 1 if there is information disclosed.

Descriptive and graphical analyses are used to understand the CSR-environmental practices of the Islamic banks in these two countries.

#### 4. Findings of Study

Based on the five years of study, it is found that there is minimal improvement in the disclosures pertaining to environmental-related practices for all the six Islamic banks (see Table 2). Even the high reporters i.e. BIMB (Malaysia) and MDSB (Indonesia) only managed to report 15 over a total of 40 items of environmental information in their annual reports. The total mean scores showed in the table indicates generally that the Malaysian banks have begun reporting 5 out of 8 items of environmental information in 2007 and improve to six environmental item of information in 2011. Out of the three full-fledged Islamic banks, BIMB has been found to be the top reporter.

Table 2 also shows that BMMB (Malaysia) and MGSB (Indonesia), the low reporters maintained with only one item of environmental disclosure throughout 2007 till 2011 (mean score of 1).

Table 2. Total environmental disclosures for full-fledged Islamic banks in Malaysia and Indonesia

	2011	2010	2009	2008	2007	Total
<b>Malaysia</b>						
<b>BIMB</b>	3	3	3	3	3	15/40
<b>BKRB</b>	2	2	2	2	1	9/40
<b>BMMB</b>	1	1	1	1	1	5/40
	6	6	6	6	5	
<b>Indonesia</b>						
<b>MMSB</b>	4	4	1	1	1	11/40
<b>MGSB</b>	1	1	1	1	1	5/40
<b>MDSB</b>	5	4	4	1	1	15/40
	10	9	6	3	3	

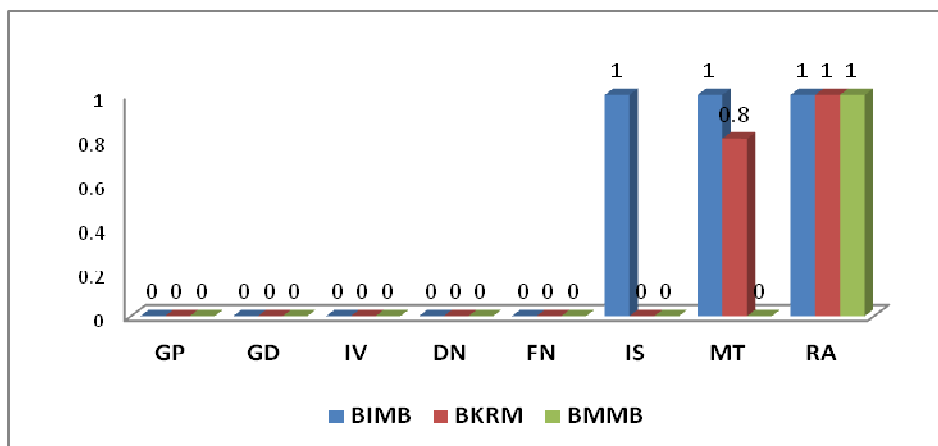


Figure 1. Mean scores of environmental-related disclosures for full-fledged Islamic banks in Malaysia

Figure 1 illustrates that generally the emphasis on specific environmental-related reporting practice by all three Islamic banks in Malaysia is somewhat of similar trend. All three banks failed to disclose any information concerning introduction of green product (GP), glossary/definition of green product (GD), investment for internal sustainable development programmes (IV), amount of donation in environmental awareness (DN) and financing in any project which may lead to environmental damage (FN). Only risk-based corrective actions (RA) have been reported by all the banks in all the five years studied.

In comparison, the Indonesian Islamic banks seem to provide more items of environmental information in their annual reports (see Figure 2). Of the eight items, only three are not reported at all throughout the five years studied; which are introduction of green product (GP), glossary/definition of green product (GD) and

financing in any project which may lead to environmental damage (FN). Interestingly, similar to the Malaysian banks, all three banks have reported the risk-based corrective actions (RA).

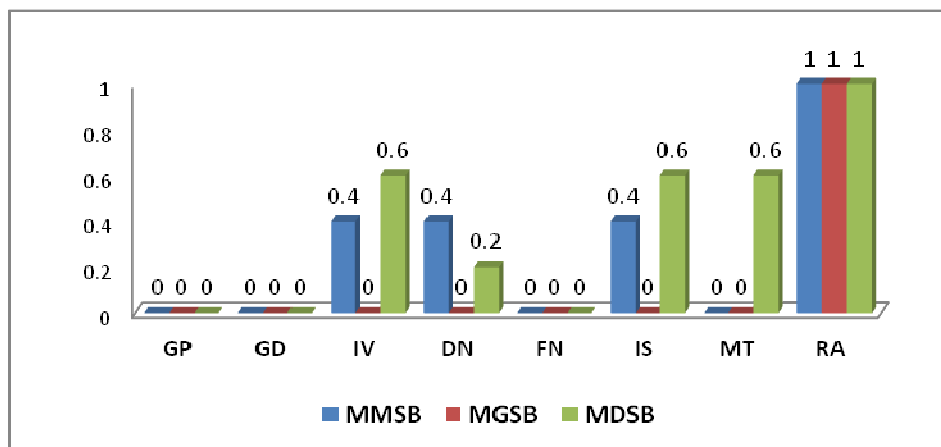


Figure 2. Mean scores of environmental-related disclosures for full-fledged Islamic banks in Indonesia

Overall, the findings from the descriptive examination put forward a preliminary idea that these Islamic banks are still lagging behind in reporting for the environment based on the Islamic laws and principles. This finding also offers insight about the need to embrace the Islamic values in business (furthermore they are Islamic organizations!), as well as greater reporting engagement by full-fledged Islamic banks.

## 5. Conclusion

Generally, the environmental reporting practices of the full-fledged Islamic banks both in Malaysia and Indonesia have been found to be quite low. Based on the AAOIFI's guidelines and significant prevailing literature, Indonesian banks, in total, have been found to make higher number of environmental disclosures in their annual report when compared to their Malaysian counterparts. Nevertheless, item related to 'risk-based corrective action for environmental matters' has been found to be reported by all the banks in the two countries. This finding indicates the efforts of the banks in establishing some form of policy or plan of actions for possible environmental-related risks.

To a degree, it is concluded that the full-fledged Islamic banks in Malaysia and Indonesia have shown their accountability in supporting the preservation of natural environment through their business operations. The study findings generally put forward a preliminary idea that the environmental reporting practices of these Islamic banks based the Islamic laws and principles are yet to improve, and that the religion is not the prime motivating factor. Hence, these findings may kick-start the respective banks as well as the relevant regulatory bodies on aspects to be improved concerning conserving the natural environment in business.

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