

ON CORPORATE SOCIAL RESPONSIBILITY OF ISLAMIC FINANCIAL INSTITUTIONS

SAYD FAROOK*

This study proposes a structured definition of the social purpose of Islamic Financial Institutions (IFIs) derived from, among other things, Islamic principles of social equity and redistributive justice. It is posited that IFIs are meant to be socially responsible for two interrelated reasons: their status as a financial institution fulfilling a collective religious obligation and their exemplary position as a financial intermediary. Specific responsibilities within this dual role are also framed allowing for a clear structured logic for IFIs to implement policies.

1. INTRODUCTION

The primary objective of this study is to ascertain, through a review of Islamic principles, a structured definition of corporate social responsibility (CSR) and the basis of this responsibility. The secondary objective of this study is to provide a pragmatic framework through which IFIs can implement CSR policies.

It is evident that there is now, more than ever a debate raging within the academic community (as witnessed in the 6th International Conference on Islamic Economics and Finance, Jakarta, Indonesia) and in the practitioner community (as witnessed in the World Islamic Banking Conference, Manama, Bahrain 2005) as to whether IFIs have achieved or are even close to achieving the objective promised 30 years ago to implement a just and equitable distribution of wealth. Further, the debate questions whether it is justified in allocating the role of a charity organization to an Islamic Financial Institution (IFI). It has been argued that IFIs are like any other conventional financial institution, which acts as an intermediary between providers of funds and fund users, the only difference being that the transactions and contracts of an IFI must comply with Islamic law.

On the other hand, others argue that implicit in the laws of Islamic finance (i.e. the spirit of the laws) is an ethical guideline to ensure that some or all of the funds

* Center for Islamic Finance, Bahrain Institute of Banking and Finance (BIBF), e-mail: sfarook@bibf.com.

provided from investors are used to redistribute wealth within society profitably. This can be done in a number of ways and have proved to be profitable areas of investment for a number of Islamic and conventional banks alike (for e.g. through micro-financing). Moreover, there are those traditional means by which to redistribute wealth through methods such as *zakāt*, *qard*, and *waqf*.

Indeed, the founding fathers of modern day Islamic finance have concurred to the view that IFIs do have a heightened sense of social responsibility, as do any other 'Islamic' institution. However, this does not entail IFIs to become uncompetitive and unprofitable charitable organizations used to only further social development objectives. This entails a change in the mindset of Islamic bankers to incorporate social development objectives into their portfolio of investments profitably.

As more investment account holders, shareholders and general stakeholders understand fully the objectives that underlie the Islamic economic system, there shall be more demand to know to what extent their local IFI fulfils those social objectives. Therefore, the IFI that extensively involves itself in CSR and demonstrates by disclosure that it is extensively involved in CSR will more easily earn the legitimacy of certain stakeholders (particularly those interested in the IFIs CSR activities), and ultimately earn their loyalty. This represents in itself a value proposition for IFIs who seek to retain clients on the basis of non-price competition.

However, this is not to say that IFIs should implement corporate social responsibility because of its long term economic benefits. While viable economic institutions have to be driven by profit incentives, in the case of IFIs, it is not their only priority and certainly not the only reason for them to implement corporate social responsibility.

Indeed, any notion that IFIs or any other institution that claims to be Islamic, for that matter, should be socially responsible must derive its justification from Islamic law and principles, as contained within the Qur'ān and the *Sunnah* of the Prophet of Islam, Muhammad (P.B.U.H). Without this ultimate source of legitimacy, there is no reason for any action.

This study provides the foundation of social responsibilities that are applicable to IFIs derived particularly from those divine sources. It is proposed that Islamic banks should be socially responsible for two interconnected reasons: first, they fulfill a collective religious obligation (*fard kifāyah*) for Muslims and hence they are in a position to fulfill an enlarged scope of responsibilities that Muslims cannot fulfill individually; second, they are in an exemplary position in society. These reasons provide the basis for the development of a structure for corporate social responsibility standards based on a dichotomy of mandatory and recommended conduct.

The study is structured as follows. Section 2 provides the basis of individual social responsibility in Islam while section 3 to discusses the extension of individual social responsibility to organizations that carry out a collective religious duty for the community of Muslims and/or are in an exemplary position. Section 5 further refines the meaning of Islamic social responsibility for IFIs and contrasts it from the social responsibility due of individuals. Section 6 develops the justification for mandatory and recommended forms of social responsibility, while section 7 develops the basis of mandatory forms of disclosure.

2. THE BASIS FOR ISLAMIC SOCIAL RESPONSIBILITY

ICSR derives itself from core principles in the holy Qur'ān. The three major foundational principles for ICSR are the vicegerency of mankind on earth, divine accountability and the duty on mankind to enjoin good and forbid evil.

2.1. Vicegerency

The principle of vicegerency denotes that mankind is the representative of Allah on earth and as such Allah has entrusted mankind with stewardship of Allah's possession. Allah states this principle in the holy Qur'ān: 'I will create a vicegerent on earth'¹; and Allah further states: 'It is he who hath made you the inheritors of the earth',²

2.2. Divine Accountability

The principle of divine accountability flows from the vicegerency principle and denotes that individuals will be accountable to Allah for all of their actions on the Day of Judgment. This principle is expounded in several verses of the holy Qur'ān, two of which are: 'Allah takes careful account of everything',³ and 'Then shall anyone who has done an atom's weight of good shall see it and anyone who has done an atom's weight of evil, shall see it'.⁴ This divine accountability is the basis for all actions of a Muslim⁵, and in turn the representative organizations of Muslims.

2.3. Enjoining Good and Forbidding Evil

The principle of enjoining good and forbidding evil encapsulates the responsibilities that Allah places on Muslims as trustees and vicegerents. Allah

¹ Surat Al Baqarah (The Heifer) verse 30.

² Surat Al Ana'm (Cattle) verse 165.

³ Surat Al Nisa (Women) verse 86.

⁴ Surat Al Zalzala (The Earthquake) verse 7-8)

⁵ One who submits to the will of Allah.

says: ‘The Believers, men and women, are protectors one of another; they enjoin what is just (accepted), and forbid what is unjust (rejected)...’⁶ and in another verse, Allah states: ‘You are the best of peoples, evolved for mankind, enjoining what is just (accepted), forbidding what is unjust (rejected), and believing in Allah’.⁷ This responsibility is overwhelming and encompasses all aspects of a Muslim’s life. It comprises a prescription towards positive (permissible and recommended) actions and a prescription against negative (impermissible and not recommended) actions. IFIs have generally ensured their operational status by avoiding negative actions. However, their approach to positive actions has been varied due to a lack of standards in the area.

The combination of these principles denotes a divine accountability for each Muslim to enjoin good and justice and forbid evil and injustice. These core principles therefore constitute the basis of individual social responsibility.

3. COLLECTIVE RELIGIOUS DUTY AND ISLAMIC FINANCIAL INSTITUTIONS

IFIs came into existence as a collective religious obligation (*farḍ kifāyah*)⁸ on the larger community (*Ummah*). This obligation is to operate a financial intermediary for individuals⁹ in the community wishing to comply with Islamic law (Sharī‘ah). To that extent, IFIs are representative organizations of individuals. The IFIs are representatives for individuals who:

- i. invest their money as shareholders or investment account holders,
- ii. have co-operative, partnership or borrowing relations with the IFI,
- iii. are employed by the IFI,
- iv. have other explicit contractual relations with the IFI,
- v. in addition to the above, have an implicit social contract with the IFI as part of the larger community (*Ummah*).

⁶ Surat Tawba (The Repentance), verse 71.

⁷ Surat Al-i-Imran (The Family of Imran) verse 110.

⁸ *Farḍ Kifāyah* refers to a collective religious duty which, if performed by some, would exempt others from performing it. However, if it is not performed by any, the entire community is sinful.

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- v. in addition to the above, have an implicit social contract with the IFI as part of the larger community (*Ummah*).

In this special position, IFIs are able to perform the obligations and recommended actions that Muslims cannot perform individually. They have the ability to influence allocative justice through their transactions, something beyond the reach of an individual Muslim, but recommended in the strictures of Islamic principles.

Second, IFIs fall in the category of highly visible institutions in society as financial intermediaries which source and allocate funds. The example set by IFIs has an impact on other individuals, institutions and organizations, who are influenced by the actions of the IFI. Indeed, IFIs have the potential to ‘teach’ individuals and communities to apply justice in all facets of their life based on the IFIs example.

It is for these two reasons that IFIs and any other representative ‘Islamic’ institution that is performing a *farḍ kifāyah*, for that matter, have a special duty of social responsibility. This social responsibility is an extension of the social responsibility of every Muslim, but it is a responsibility that Muslims do not have the capacity to perform individually.

4. THE NOTION OF ISLAMIC SOCIAL RESPONSIBILITY FOR ISLAMIC FINANCIAL INSTITUTIONS

In its core form, the responsibilities due of a representative organization such as IFIs are the same as the individual social responsibility of each Muslim: to enjoin right and to forbid wrong. The definition of right and wrong in Islam can be defined in various dichotomies which are overlapping. In their legal form, right refers to everything that is permissible or recommended (*ḥalāl* and *mustahab* respectively), while wrong refers to everything that is impermissible or not recommended (*ḥarām* and *makruh* respectively). From the perspective of Islamic jurisprudence, right refers to what is just while wrong refers to what is unjust.

However, because IFIs are a collective religious obligation (*farḍ kifāyah*), the definition of right and wrong are sometimes of a different nature than those that apply to individuals. This is because IFIs have a special religious and financial position in society.

Religiously, IFIs have a responsibility to comply with the form and substance of Islamic law in all aspects of their operations. This is because they are in a representative and exemplary religious position, whereby they represent the interests of their stakeholders and at the same time are exemplars to their stakeholders. This implies that all aspects of their operations should be conducted in a permissible or recommended manner while no aspect of their operations should ideally be conducted in an impermissible or not recommended manner. If it

is conducted in an impermissible or not recommended manner, it is an obligation to disclose to its stakeholders the reasons for that particular conduct.

Financially, IFIs are intermediaries which mobilize funds from investors and allocate funds to projects and other investments. In this context, it is the responsibility of IFIs to mobilize funds from permissible and recommended sources and invest funds in permissible and recommended projects. Further, IFIs are also in an exemplary position as financial intermediaries and hence can significantly impact the conduct of the IFIs stakeholders in terms of the ideal Islamic investment and allocation process.

It is for these two reasons that IFIs have a contrasted social responsibility to that of individuals. For instance, individuals have limited capacity to avoid *ribā* in financial systems that are overwhelmingly based on *ribā*. Hence, IFIs were created to avoid this form of impermissible activity. This can be extended to recommended types of activities such as the allocation of funds for the purposes of the benefit of society or to alleviate poverty. These activities can only be performed in a limited extent by individuals due to minimal scale economies, but are recommended of individuals through charity and helping those who are destitute. The overall theme encouraged by Islam is one of assisting those who are in a relatively disadvantaged position in society because of circumstances. In this context, IFIs can perform these functions profitably and efficiently because of the sheer scale of their operations compared to individuals.

The nature of responsibility of IFIs can further be distinguished from charitable organizations which exist in Islamic societies, which are also a function of individual social responsibility. Charitable organizations only redistribute wealth, while IFIs have the dual ability to redistribute wealth and allocate wealth to selective investments that contribute to the betterment of society. It is this allocation power that differentiates IFIs from other institutions and indeed bestows upon it special responsibilities.

However, it is widely cited that IFIs generally only perform a part of their social responsibility. As stated above, social responsibility is comprised of a prescription towards positive (permissible and recommended) actions and a prescription against negative (impermissible and not recommended) actions. IFIs are widely accused to have generally ensured their operational status by avoiding negative actions or impermissible activities, while minimally and variedly conducting recommended activities.

This may be a function of two overlapping issues. The first issue is that IFIs are unsure of what is expected of them based on Islam other than to avoid *ribā* and *gharar*. In this confusion their approach to social responsibility widely varies based on individual IFI preferences. The second issue is that, even if it is assumed that

IFIs are conducting their social responsibility activities, they may not be informing the rest of society through disclosure, leading to an expectations gap. This may be despite the fact that IFIs are complying to the fullest extent of their abilities with Islamic notions of social responsibility.

It is in this context that it is recommended that regulatory authorities standardize the notions of social responsibility that are mandatory and recommended for IFIs if they are to remain as Islamic organizations. Mandatory forms of social responsibility refer to conduct that must be carried out or conduct that must be avoided. Recommended forms of social responsibility are one step further, in that it defines the kinds of conduct that the IFI should engage in if it has the ability/capacity. This is based on the intuition of the Qur'ān where Allah states: 'On no soul doth Allah Place a burden greater than it can bear'.¹⁰ Allah does not impose a burden on individuals greater than they can bear. It is for this reason there are duties that Allah commands us to do (*ṣalāh*, *zakāh*, *hajj* etc), while there are duties that Allah recommends for us to do for additional rewards and our betterment.

It is proposed that any notion of social responsibility for IFIs should be designed to meet this divine theory of regulation. Hence, it is suggested that IFIs must comply with some mandatory guidelines that are fundamental to their existence as IFIs (mandatory), while it is recommended that they undertake voluntary activities if it is within their capacity.

5. THE JUSTIFICATION FOR MANDATORY AND RECOMMENDED FORMS OF CSR

5.1. Mandatory Forms

Mandatory forms of social responsibility refer to conduct that the IFI has to avoid, in its capacity as a representative institution that serves a collective Islamic religious obligation. These responsibilities, if not carried out will mean that the IFIs are not complying with fundamental edicts of the Qur'ān. This form of social responsibility does not need a significant expenditure of resources and is within the reach of all IFIs regardless of their country of origin, legal form or size. This is because such mandatory forms of social responsibility are mostly prescriptions to avoid (for e.g. such as *ribā*) rather than prescriptions to act. However, that does not necessarily mean that the IFI does not have to implement policy and therefore expend some resources to avoid these actions.

¹⁰ Surat Al Baqarah (The Heifer) verse 286.

Screening of investments

Muslims cannot invest their money in enterprises that engage in impermissible activities, for instance, pig farm, alcohol producing factory, tobacco industry etc. Furthermore, they cannot invest in activities that are financed by debt or interest based activities. These requirements are directly applicable to IFIs as representative organizations. Hence, in this context, it is imperative that IFIs screen their investments for compliance with Islamic laws and principles. IFIs should have a clear policy outlining their method of screening investments and the depth of their screening. IFIs should also gain approval of this screening process from their Shari'ah Supervisory Board.

Earnings prohibited by Shari'ah

Since Muslims cannot also engage in impermissible activities, earnings from impermissible activities are impermissible to be utilized for the operations of the firm and must be dealt with according to the Shari'ah Supervisory Board's opinion. To that extent, Islamic stakeholders need to be assured that the representative IFI is acting in accordance with Islam by ensuring that no part of the stakeholder's wealth or income or activity is impermissible, and where it is impermissible, how it is dealt with.

Responsible dealings with clients

As representatives of Islamic stakeholders, IFIs need to ensure that they substantively follow Islamic prescriptions on how to deal with debtors as stipulated in the holy Qur'an: 'If the debtor is in difficulty, grant him time till it is easy for him to repay. But if you remit it by the way of charity, that is best for you if you only knew.'¹¹ The Qur'anic prescription contains a mandatory and a recommended action. The mandatory action in this circumstance is allowing the debtor time to pay it off if he/she is in difficulty. Indeed, the substance behind the prohibitions against *ribā* (usury) was to ensure that clients do not fall into excessive debt.¹² To fulfill this prescription in its true substance, IFIs should implement both *ex ante* (prior to giving fund to a client) and *ex post* (when the client is in financial difficulty) measures. *Ex ante* measures should include provisions of the policy ensuring that the Shari'ah Supervisory Board or its agent review every contract form to avoid onerous terms being imposed on clients, who may be in a weaker bargaining position relative to the IFI. Other *ex ante* measures should include due process provisions whereby the bank must assess the disposable income capacity of the client, so as to take into consideration the client's ability to repay and the

¹¹ Surat Al Baqarah (The Heifer) verse 280.

¹² For an in-depth analysis of the substantive intuition behind Islamic laws and their place in the development of Islamic pre-modern laws, please see El-Gamal (2006).

subsequent effect on the client's financial and overall well-being. In the event that *ex ante* measures are not effective to prevent insolvency of clients perhaps caused by external economic or personal circumstances, *ex post* measures should clearly stipulate the rights and obligations of both parties to the contract, particularly with regards to the conditions under which late penalties will be charged and under which conditions IFIs will defer collection of debt. For the purposes of transparency and fairness to clients, IFIs should also stipulate these conditions to the client prior to the settlement of any contract.

Employees

Justice forms the core of Qur'anic prescriptions and therefore IFIs must be just in all its dealings with employees, customers, and all other members of society. Employees are a vital facet of IFI operations and they are sometimes in an unequal bargaining position with IFI management. As a result, onerous conditions on the employees and paltry wages may be characteristic of these situations. The Qur'anic principle of brotherhood¹³ is particularly pertinent in the discussion of the treatment of employees as Muslims treat one another as brothers. This relationship extends to the working relationships established in IFIs as IFIs are regulated primarily by Islamic principles. The relationship between employer and employee should therefore be based on Islamic moral and ethical principles of justice and divine accountability as applied between Islamic brethren. This places a responsibility on IFI management to ensure that the employees are treated with justice and that they are valued regardless of their position in the bank. IFIs therefore should have a policy on the fair treatment of employees. This policy should encompass providing an environment free of exploitation and discrimination, free from class or race barriers and equal opportunity for all based on merit regardless of gender, race, religion, disability or socio-economic background.

Zakāh

Paying *zakāh* is a mandatory obligation on the part of all Muslims to purify their wealth, regardless of mental health or youth. AAOIFI has already mandated standards for the accounting treatment of *zakāh* (FAS 9). However, these standards do not recommend the creation of a policy on *zakāh* as is part of the obligatory social responsibility of Muslims. To complement this existing standard, the ICSR standard would mandate that there is a policy for *zakāh* in every Islamic institution that is unambiguous about the obligations of the IFI with regards to collection and payment of *zakāh*. It is nevertheless acknowledged that there is controversy in the Islamic literature as to whether Islamic businesses are obligated to pay this tax, or whether it is only obligatory for only individuals (Shihaddeh, 1987, p.32; Gambling and Karim 1991, p.103). To that extent, some IFIs do not necessarily

¹³ Surat Al Hujraat (The Apartments) Verse 10.

need to establish a policy on *zakāh*, unless it is voluntary and they feel it is in the capacity of the IFI. Hence, the direction taken by AAOIFI in this regard should be either to supplement the existing standard on *zakāh* to mandate a policy for those IFIs that have to pay *zakāh* to their government and for those IFIs that voluntarily pay *zakāh*. Alternatively, there should be an ICSR provision which mandates the establishment of a *zakāh* policy as a mandatory form of ICSR for those IFIs that have to pay *zakāh* and as a recommended form of ICSR for those IFIs that do not have to pay *zakāh*.

5.2. Recommended Forms

Recommended forms of social responsibility refer to those actions that go beyond the mandatory requirements and are done purely on a voluntary basis based on the capacity of the IFI to undertake such activities. As representative organizations, IFIs should feel the need to engage in whatever recommended activity that it can in its capacity. This is in line with the Islamic vision of spreading Islamic justice through all facets of an individual's life and consequently all aspects of the IFIs operation. Some of the recommended actions derive from the position of the IFI in society as a financial intermediary, while others are purely operational aspects that affect any Islamic business. The categories are self-explanatory and are founded on Qur'ānic principles of justice/equity.

Qard Hasan

Qard hasan is the only type of loan recognized in Islam. Allah refers to it in the Qur'ān: 'Who is it that will give Allah a gratuitous loan (*qard hasan*), which Allah will double into his credit and multiple many times?'¹⁴ It is a gratuitous loan given to needy people for a fixed period without requiring the payment of interest or profit. The recipient is only required to repay the principal. As a financial intermediary, IFIs are in a special position in society to encourage *qard hasan* activities both within it and with its clients and customers. This is because IFIs are able to direct funds from depositors and customers and also allocate them to the neediest purposes. No other social organization has the opportunity to offer the specialization in intermediation that IFIs can. For instance, IFIs can open special *qard hasan* accounts through which deposits can be received, which would then be transferred to needy clients such as those unable to pay their dues to banks or newly married couples unable to purchase household items or students unable to get an education as a result of financial strife. IFIs can run special fund raising campaigns to increase their *qard hasan* funding with minimal marginal expenditure through the existing infrastructure of the IFI.

¹⁴ Surat Al Baqarah (The Heifer) verse 245.

Reduction of impact on the environment

As vicegerents of Allah in earth, Muslims are accountable to Him to protect and preserve what He has entrusted them with (*amānah*). Destruction of or damage to the physical environment, if it is considered harmful to the interests of the individual or the society at large, is prohibited in Islam. Indeed, it is necessary for every individual to ensure that their actions have minimal environmental consequences. While financial intermediation itself does not have direct environmental consequences, projects funded by the IFI may have a harmful environmental impact. As a trustee of several contracting parties including individuals and organizations who deposit or invest their money with the IFI, the IFI has a recommended responsibility to ensure that such harmful investments are avoided and that the IFI actively promotes, through investment quotas, projects that have a beneficial impact on the environment. Of course, this would only be encouraged for those banks that have the capacity, financial or otherwise, to sustain such policies.

Screening clients and contractors (additional criteria)

Depending on their bargaining power with clients and contractors and infrastructure capacity, IFIs can both screen and negotiate terms with clients and contractors to ensure their activities comply with Islamic principles as contained in the mandatory section of the proposed standard. For instance, they can ensure that clients and contractors businesses do not associate with other contractors that support or engage in activities such as usury (*ribā*), alcohol gambling (*maysir*), extreme uncertainty (*gharar*), tobacco or arms production. Further, IFIs can also ensure that contractors also treat their employees to the standard applied in the IFI itself. This is consistent with Islamic accountability and allows for IFIs to enjoin good and forbid evil to the fullest extent of their capacity. In addition, the implementation of such screening can complement the usual screening process run by IFIs for the purposes of assessing credit worthiness and character etc. To that extent, minimal financial outlay will be required if the existing infrastructure is sufficient.

Industry wise investment quotas

In line with its responsibility to enjoin good and forbid evil in a macro-financial scale, IFIs are able to implement policies to ensure that investments are directed towards those industries that are most beneficial to economic development and are also aligned to Islamic principles of social equity and redistributive justice. IFIs have a special financial position whereby they are entrusted with funds from individuals and other organizations. The sheer size of the funds implies that IFIs are able to utilize economies of scale in investing. To that extent, they are also able to utilize these economies to invest in ventures that lead to socio-economic

development, in contrast to individuals who are unable to diversify and invest in such ventures due to lack of economies of scale and other factors. This does not preclude the fact that IFIs will invest in such industries based on the underlying economic rationality of the particular venture/project, not on altruism. Individual research undertaken by the banks could lead to an appreciation of the particular industries that drive greater economic development, while at the same time reducing income parity between the wealthy and the poor.

Social impact based investment quotas

Since IFIs have a special financial position (because of their diversification capabilities and economies of scale), they are able to invest in industries that produce social, cultural or religious development in line with Islamic ideals. IFIs can set aside a portion of their investment quota as a target for increasing investments in social impact based projects. Again, individual research undertaken by the banks could lead to an appreciation of the particular projects that have the greatest social impact. For instance, positive NPV investments in projects such as welfare centers or religious centers can be classified as social impact based investments. Alternatively, investments in projects that lobby for human rights or reducing child labor or greater female participation in the economic or political process, could be classified as social impact based investments. Again, this does not preclude the fact that IFIs will invest in such projects based on the underlying economic rationality of the particular venture/project, not on altruism.

Environmental impact based investment quotas

In line with the principle of vicegerency and accountability (see section on *Reduction of impact on environment*), IFIs are able to direct funds, through establishing quotas, to investments that have a positive environmental impact. The parameters of such a policy would of course have to be discussed in the individual IFIs and it would only be encouraged for those banks that have the capacity to sustain such policies.

Par excellence customer service

Islamic ideals of brotherhood imply a treatment of all human beings with dignity and respect as is evidenced in numerous verses of the Qur'ān.¹⁵ Allah prescribes Muslims are to greet others with a greeting better than the greeting they receive: 'When a (courteous) greeting is offered you, meet it with a greeting still more courteous, or (at least) of equal courtesy. Allah takes careful account of all

¹⁵ Surat Al Mumunoon (The Believer) Verse 52, Surat Al Anbiya (The Prophets) Verse 52, Surat Al Hujraat (The Apartments) verse 10

things.’¹⁶ Indeed manners are emphasized as the most important attribute of an individual’s Islamic character as emphasized by the Prophet Muhammad (PBUH): ‘The best amongst you are those who have the best manners and character’.¹⁷ To that extent, IFIs as representative Islamic organizations should require its agents (employees and contractors) to provide the best service possible to its clients and customers, regardless of their status, financial or otherwise. Besides teaching staff about Islamic manners, IFIs should utilize performance measures and incentives to encourage employees to behave with the best of manners between each other and with clients and customers.

Micro and small sized business and social savings and investments

A key principle of Islam in achieving its ideal of redistributive justice is the support and empowerment of the weak. Indeed, numerous verses of the Qur’ān point to the assistance of the weak (in education, economic, family affairs).¹⁸ This can be achieved most significantly through the financial empowerment of family units in the lowest echelons of society. Micro and medium sized business can usually be run by such families if given the appropriate seed capital to initiate business. IFIs can also make profitable divisions serving this class of clients, particularly because existing examples of conventional micro-credit banks are very successful (for instance, Grameen Bank).

Employee welfare (extension)

As previously stated in the mandatory section, employees should be treated on the basis of the principle of brotherhood in Islam. This requires some mandatory acts to be definitely carried out to ensure that their rights are protected even though they are likely to be in an unequal bargaining position. Examples of these include pay/salary guarantees, equal opportunity and no discrimination. Beyond this, it is encouraged to create provisions for employee treatment that achieve the Islamic ideals of social equity. Social equity in practice requires Muslims to provide opportunities for those classes/segments of society that require it the most; not by giving them charity, but employing them in productive activities. Examples of such practices include establishing pro-active quotas in employing staff that are disabled, from disadvantaged backgrounds, from minority groups and/or from under-represented groups.

¹⁶ Surat An Nisa (The Women) Verse 86

¹⁷ Translation of Sahih Bukhari, Virtues and Merits of the Prophet (pbuh) and his Companions, Volume 4, Book 56, Number 759

¹⁸ For instance, Surat Al Baqarah (The Heifer) Verse 273 or Surat An-Nisa (Women) Verse 436

Charitable activities

Numerous verses of the Qur'ān encourage Muslims to give charity.¹⁹ As a representative Islamic organization, it is recommended that IFIs also give charity to the fullest extent of their capacity. As a financial intermediary, IFIs are in a special position to source charitable funds, both from within and without the IFI, for deserving causes. With minimal financial outlay, IFIs are able to create charity accounts and fund raising drives for charity from customers and clients to complement their banking operations. This will allow IFIs to utilize their existing capacity for the benefit of society's most deserving individuals.

Waqf management

Awqāf (religious endowment) are a vital part of Islamic infrastructure due to the crucial Islamic services their revenues provide. Because IFIs already have the technologies to provide efficient financial intermediation, they can play an important role in securing revenues from *awqāf* and distributing it to the specified charitable causes, with minimal marginal outlay.

6. DISCLOSURE AS A MEANS OF ACCOUNTABILITY

Disclosure is a crucial aspect of the accountability function of an IFI to its stakeholders. The other such accountability function is the Sharī'ah Supervisory Board. However, the Sharī'ah Supervisory Board cannot often disclose all or any social responsibility duties. Hence, it is required that IFIs disclose as much information in a succinct, truthful and understandable manner to its stakeholders.

From an Islamic perspective, the main objective of corporate reporting that overrides other objectives is to allow Islamic enterprises to show their compliance with Sharī'ah (Baydoun and Willett 1997). The implication of this objective is that IFIs have a duty to disclose all information necessary to its stakeholders about their operations, even if such information is adverse to the IFIs interest (Maali, Casson and Napier 2006). This is derived from the divine duty of accountability that each Muslim bears. However, this is not to say that Allah needs to know through disclosure the activities of the IFI. Indeed, Allah knows and hears everything and is Omniscient: 'I know what you reveal and I know what you hide'²⁰ and also: 'He knows what is manifest and He knows what is hidden'.²¹ As representative organizations, IFIs have a duty to disclose their compliance with the principles and laws of Islam to stakeholders. This is because the stakeholders (Muslim or otherwise) have a relationship or are represented in some form or manner by IFIs

¹⁹ For instance, Surat Al Baqarah (The Heifer) Verses 43, 110, 177, 273, 283.

²⁰ Surah An-Nisa (Women) verse 33.

²¹ Surah Al-Ala (The Most High) verse 7

even if the IFI has no direct contractual relationship with the individuals. As Maali *et al.* (2006) explains, 'the requirement for Muslims to uncover the truth is intended to help the community to know the effect of a person or a business on its wellbeing' (p.273). It is this social dynamic that makes it essential that IFIs disclose all relevant information truthfully to its Islamic stakeholders.

Maali *et al.* (2006) categorizes three broad objectives that are used as the basis for social responsibility disclosures by Islamic businesses:

1. To show compliance with Islamic principles and laws, in particular dealing justly with different parties.
2. To show how the operations of the business have affected the well-being of the Islamic community.
3. To help Muslims to perform their religious duties.

As of now with the current AAOIFI standards, there is an expectations gap in all but one of the three broad objectives. IFIs are only mandated by existing AAOIFI standards to help Muslims perform their religious duties through the standard on *zakāh*. However, IFIs are not mandated by AAOIFI to show full compliance with Islamic principles and laws, nor are they mandated by AAOIFI to show how the operations of the business have affected the well-being of the Islamic community. To that extent, it is important that AAOIFI promulgate ICSR disclosure standards that mandate the disclosure of such important information to the stakeholders of an IFI.

7. CONCLUSION

This study provides the basis for ICSR for IFIs and the justification for developing a flexible ICSR standard that encompasses both mandatory and recommended forms of ICSR. It further provides the accountability foundation for mandating disclosure of ICSR conduct. Standard setting bodies such as the AAOIFI have the ability to influence the activities of IFIs by giving them flexible ICSR provisions that they can adopt depending on their underlying economic capacity. It is hoped that these standards will provide the impetus, long desired in the Islamic community, for IFIs to incorporate Islamic social responsibility principles in all aspects of their activities. To that extent, it is acknowledged that many IFIs do perform ICSR activities and already have ICSR provisions that are not recorded or disclosed. It is anticipated that the recommended ICSR standard will provide a uniform and consolidated basis for IFIs to carry out their ICSR conduct. Further, it is hoped that the disclosure as recommended here of the ICSR provisions and ICSR performance of the IFI will fill a long held expectations gap about what IFI are 'supposed' to be doing as Islamic institutions.

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