

Corporate Governance of Islamic Financial Institutions in Malaysia

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ABSTRACT

Given the phenomenal increase in Islamic banking activities globally, it is important that there exists good governance practices of Islamic financial institutions (IFIs). This is primarily to ensure its sustainability in the long run. More importantly, in order for Islamic banks to play an optimum role in the development of Islamic countries, it is imperative to develop regulatory structures which can help to control fraud, exploitation, and un-Islamic behaviour in banking practices. Additionally, the development of strong governance practices will win public confidence, thereby promoting trust amongst equity holders, investors and other parties dealing with these IFIs. However, promulgating and developing standards and guidelines on corporate governance (CG) may not be adequate. Thus, this paper examines the extent IFIs are adhering to such guidelines. There are two stages to this study. First a disclosure index was developed using the guidelines issued by the Central Bank of Malaysia (BNM), the standard on CG promulgated by the Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI) and the framework introduced by the Islamic Financial Services Board (IFSB). The index developed in the first stage was then used to assess the annual reports of all the 16 IFIs operating in Malaysia. It was found that on a scale of 0 to 100, the CG disclosure index ranges from a low of 42.28 to a high of 68.29, with the average score of 51.42. This shows that IFIs are not particularly motivated to disclose specific-governance related information. On

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the basis of the stewardship theory, however, these elements reflect the accountability of IFIs towards their stakeholders.

Keywords: Corporate Governance Disclosure Quality, Islamic Financial Institutions (IFIs), Malaysia

JEL Classification: M40

1. Introduction

A series of corporate failure of “giant” corporations worldwide (e.g., Enron, Tyco, Worldcom, Pharmalat) has shaken the confidence and trust of stakeholders. This has brought about an increased attention to corporate governance (CG) issues. The increasing CG disclosures in annual reports may be interpreted as a way by which firms try to secure the confidence and trust of their stakeholders. More importantly, the requirement for CG disclosures as a consistent support of transparency, has now become a pertinent tool. Bhat, Hope, and Kang (2006) indicate that knowledge of a firm’s governance practices is a useful tool in assessing the credibility of the financial information presented in its annual report. This is because governance-related disclosures signal the openness of the firm. Additionally, such information will also facilitate users of the annual report in assessing the quality of the information besides guiding them in developing more accurate expectations about the future of the firm’s performance. Specific to Islamic banking, one observes a proactive stance on the part of regulators to improve the regulatory and supervisory framework in supporting higher CG standards for Islamic financial institutions (IFIs). Given the uniqueness of IFIs, it appears that an international guideline developed by OECD or the Cadbury Report may not adequately address the specificity of CG issues in IFIs. Since governance structure is industry specific (Adam & Mehran, 2003), it is thus necessary to highlight the distinct elements of CG issues in the Islamic banking industry.

In line with the global focus on CG, various regulatory bodies for IFIs have moved considerably towards improving the regulatory and supervisory framework for the purpose of developing CG standards which are customised to the nature of Islamic banking. The CG guidelines and standards issued by the Accounting and Auditing Organizations of Islamic Financial Institutions (AAOIFI), the Islamic Financial Services Board (IFSB) and the Central Bank of Malaysia (BNM) are some examples of the *Shariah* governance framework introduced for the purpose of addressing the governance of IFIs. Specifically, the

Central Bank of Malaysia in 2007 issued the “*Guidelines on Corporate Governance for Licensed Islamic Banks*” (GP1-i), AAOIFI promulgated six “*Governance Standard for Islamic Financial Institutions*” (GSIFI nos. 1 to 6) in 2008 and the Islamic Financial Services Board issued the “*Guiding Principles on Corporate Governance for Institutions Offering Only Islamic Financial Services (Excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds)*” (IFSB-3) in 2006 (hereinafter collectively referred as the ‘Guidelines’).

These Guidelines may well assist IFIs to establish their governing structures. Consequently, these may help improve the governance practices of IFIs and thus enhance their transparency. However, the establishment of the standards and guidelines on CG alone are insufficient if they are not fully complied with by the IFIs. This study attempts to examine the disclosure quality of the IFIs in Malaysia. Consistent with prior studies such as Hameed and Sigit (2005) and Hassan and Christopher (2005), this study uses a comprehensive corporate governance disclosure (CGD) index as a proxy for disclosure quality. The CGD index used in this study is based on the Guidelines issued by AAOIFI, IFSB and the Central Bank of Malaysia in 2008, 2006 and 2007 respectively. The choice to base the index on these three Guidelines is primarily because they effectively encapsulate all of the governance disclosures envisaged for IFIs. The assessment of the level of CG across IFIs is benchmarked against the CGD index developed in this study. The results of the study reveal the varying levels of CG quality among the IFIs and the different elements of CG coverage in the respective IFIs’ annual report in the year subsequent to the Guidelines incorporated in the comprehensive CGD index.

This study contributes to the literature in several important respects. First, the use of a comprehensive index aggregating all possible CG issues released by regulatory bodies is expected to broaden the literature on CG in IFIs. Second, the CGD index developed from three governance guidelines which are applicable to IFIs (2006, 2007 and 2008) demonstrates the originality of the research.¹ Despite recent revisions of the guidelines by the Islamic Financial Services Board (IFSB) and the Central Bank of Malaysia (BNM) (in 2009 and 2010 respectively),

¹ The study was conducted in 2010 and the three guidelines/standards chosen were the most current *Shariah* Governance framework at that time. However, given the evolving nature of Islamic banking and finance, the Central Bank of Malaysia issued a revised *Shariah* governance framework for IFIs in 2010 and the IFSB in 2009. This will be further discussed in Section 5 (Conclusion) of this paper.

the former guidelines used in the current study are still applicable because the guiding principles behind them remain the same. Hence, the results may serve as a point of reference for future studies tracing any development in regulatory revision in CG guidelines. Finally, the division in terms of general and specific governance related information, to the best of the authors' knowledge, is a first in studies concerning CG and IFIs. Understanding the quality of CG disclosure through examining its extent and focus is a fundamental starting point in gaining insights into the preference of IFIs on CG disclosure information. The remainder of the paper is structured as follows. The following section discusses the literature review while Section 3 focuses on the theoretical framework of the study. Section 4 describes the procedure of data collection and the findings, while Section 5 provides the conclusion.

2. Literature Review

Corporate governance (CG) is broadly defined as a set of processes, policies and laws affecting the way an organisation is directed, administered and controlled. Bandsuch, Pate, and Thies (2008) define CG as a set of formalised values and procedures implemented by the owners, directors and the management of the business in its various operations as well as its interactions with stakeholders. Holder-Webb, Cohen, Nath, and Wood (2008) define CG as the provision of effective board, strong shareholder rights, and broad disclosures in managing a business.

The issue of CG is a global concern. Prior studies (e.g., Aboagye-Otchere, Bedi, & Ossei Kwakye, 2012; Shrives & Brennan, 2015) focusing on transparency and disclosures relating to CG as mechanisms of checks and balances to control agency risks resulting from the separation of ownership and control in modern companies have been highlighted by Jensen and Meckling (1976). Good CG is beneficial to shareholders as it plays an important role in reducing agency risks resulting from the asymmetrical information between managers and investors.

The concept of CG does not differ much from the Islamic perspective as its main objective is to protect stakeholders' interests (Ahmed, Imamuddin, & Siddiqui, 2013). According to Grais and Pellegrini (2006), corporate stability, financial performance and the ability to intermediate sources of finance depend on stakeholders' confidence in individual institutions and the industry. A particular confidence feature in respect of Islamic financial institutions is the

requirement of conveying to stakeholders the information that their financial business is conducted in conformance with *Shariah* (Ahmed et al., 2013). As advocated by Chapra and Ahmed (2002), the primary concern in *Shariah* relates closely to the notion of equitable protection of the rights of all stakeholders irrespective of equity holders or otherwise.

From the perspective of IFIs, conformity with *Shariah* is the priority. For instance, the governance which particularly addresses issues pertaining to the role and conduct of the *Shariah* Supervisory Boards (SSB) is important. The CG of IFIs is also important for the following reasons:

1. It safeguards the interests of Investment Account Holders;
2. Its compliance with *Shariah* requirements;
3. Governance and risk management of *Mudaraba* and *Musharaka* contracts; and
4. Establishment of a comprehensive CG framework articulating the fiduciary responsibilities of the board and senior management.

Proper management of the above will lead to an improvement in public's level of trust and confidence within the Islamic banking industry (Iqbal & Greuning, 2008). More importantly, strong governance practices will win stakeholders' confidence and thereby promote trust among their equity holders, investors and other parties dealing with them (Chapra & Ahmed, 2002). Subsequently, this would ensure the sustainability of the industry.

In order to examine if differences exist between the CG of IFIs and other organisations, it is important to understand the unique characteristics of IFIs which emanate from the fundamental principle of conducting their operations in accordance with *Shariah* principles. The primary issue is the prohibition of the receipt and payment of *riba* (interest). One critique for a pre-determined fixed rate of return on capital where one party bears the risk while the other party receives a reward irrespective of the outcome of the use of the borrowed amount would mean an uneven distribution of risk and reward in the transaction. More importantly, *riba* also leads to the concentration of wealth by transferring wealth from the poor to the rich. These are primarily the reasons for the prohibition of *riba*. An alternative mechanism employed by IFIs to avoid dealing with interest is the application of the various forms of profit-sharing contracts which are peculiar to Islamic banking. These contracts are said to enhance justice and equitable distribution of profits and risks in investments (Bashir, 1984).

Archer and Abdel Karim (2007) identify two main types of accounts offered by IFIs in order to mobilise funds from its customers. These are current accounts and investment accounts which are based on profit-sharing and loss-bearing *mudharabah* contract. The current accounts are sight deposits which can be withdrawn at any time and are not entitled to any return. In contrast, the investment accounts which are in the form of *mudharabah* contract are more like equity shares. They are of limited duration and holders have the right to withdraw their funds.

The relationship between the investment account holders (IAH) and the bank is that of a financier as a provider of funds and a fund manager. There is a transfer of control over investment decisions from the IAHs to the bank as a *mudharib*. Though IAHs as capital providers have the right to determine the policies regarding the investment of their funds, the control over investment decisions for the *mudharabah* accounts is practically transferred to the IFIs. Thus, the IAHs have no right to intervene in the *mudharib's* decisions over the funds. Further, IAHs do not possess any right of governance or oversight, making this a unique feature of the relationship between the IFI and its IAHs.

Udovitch (1970) argues that in a *mudharabah* contract, the bank as a *mudharib* acts as a steward with respect to the capital entrusted to it. As such, the bank is not liable for any loss incurred in the normal course of business *and* if there is no negligence (Archer & Abdel Karim, 2007, p. 315). This particular aspect of *mudharabah* then gives rise to the importance of proper governance procedures in order to ensure the rights of IAHs are not compromised. In the absence of a right to manage, the only practical choice available to the IAHs is to withdraw their funds when there is dissatisfaction with the IFIs' performance.

Another major issue pertinent to IFIs is the need for IFIs to balance financial performance with ethical behaviour. The latter provides an incentive to disclose specific-governance information which may not necessarily attribute to financial outcomes but more for attaining fairness and equity to a wider group of stakeholders. In several important respects, the specificities of IFIs may impact on how CG should be structured. According to Errico and Farahbaksh (1998), depositors of IFIs have more incentive to assess the performance of the banks because their capital value and returns on investment deposits are not fixed and guaranteed. The outcome of their investments depends on the IFIs' performance in investing the depositors' funds. Indeed there is incentive to scrutinise the performance of banks by depositors to ensure protection of the capital value of their funds as well as to ensure that

the rates of return paid to them reflect a fair application of the Profit and Loss Sharing (PLS) principles (Errico & Farahbaksh, 1998, p. 14).

Lewis (2005) contends that there are two aspects which give shape to the nature of Islamic corporate governance (ICG). The first aspect is the *Shariah*. The Islamic corporate governance model is premised on the *Tawhidic* epistemological model where the functional role of an organisation aligns with the dictates of the *Shariah* (Hamid, Haniff, Othman, & Salin, 2011). The *Shariah* claims sovereignty over all aspects of human life including ethical and social matters. Thus, every act of a believer must conform to the *Shariah* and ethical standards derived from Islamic principles. The ethical principles define what is true, fair and just, the nature of corporate responsibilities, and the priorities to society. The achievement of those ethical objectives comes with some specific governance standards. More importantly, the ethical production and distribution are regulated by the *halal-haram* code and they adhere to the notion of *'adl* (justice). The second aspect is the specific feature of Islamic economics and financial principles. From Islam's perspective, the *Shariah* governs man's social, economic and political behaviour. Most importantly, being God given, the *Shariah* is the manifestation of His infinite mercy; the only true embodiment towards the best way to implement justice. While contemporary corporate governance practice discounts religion as a possible influence on CG, the same cannot be said for the *Shariah* corporate governance framework.

The appointment of the board of directors, as the top representatives for stakeholders, is not a trivial issue in Islamic CG. Chapra (2007) identifies three matters of importance that are related to the issue. The first pertains to the need for a board member to possess a high degree of moral integrity and professional competence in the banking business. These qualities may enable the board member to effectively perform his/her expected duties towards the institution. The second matter is to ensure that the board member is well-versed in *Shariah* matters concerning Islamic banking. Finally, a board member must ensure that there is adequate transparency in the disclosure of the activities of IFIs. More specifically, the *Shariah* Supervisory Board of each IFI must ensure that the IFI adheres to guidelines/standards laid down by the supervisory authority of the country. In Malaysia, for example, the guidelines issued by the Central Bank of Malaysia would rank first.

The use of guidelines to constitute disclosure indices is not new for studies of CG in IFIs. Hameed and Sigit (2005) conducted a comparative study of CG disclosures in the annual reports of Malaysian and

Indonesian IFIs between the period of 2000 and 2003. They developed a CG disclosure index which includes important issues related to IFIs such as the internal *Shariah* compliance review, social responsibilities for stakeholders, bases for profit allocation between owner equity and IAHs, the PER (profit equalisation reserve), IRR (investment risk reserve) and the *Shariah* Supervisory Board (SSB). The score for each bank was rated using the rule of classification as suggested by Irwanto (2002).

Hameed and Sigit (2005) grouped the scores into four categories: between 81 and 100 (Very informative); between 66 and 80 (Sufficiently informative); between 51 and 65 (Less informative) and between 0 and 50 (Not informative). According to the study, there is an increasing trend of CG disclosures for IFIs in both Malaysia and Indonesia with Malaysian IFIs reporting a higher score, ranging from “not informative” (i.e. a score between 0 and 50) to “sufficiently informative” (i.e. a score between 66 and 80). In comparison, scores for IFIs in Indonesia ranged from 0 to 50 (Not informative). Hameed and Sigit (2005) find that none of the IFIs disclosed specific items which are unique to them for example the internal *Shariah* compliance review and bases for profit allocation between owner equity and IAHs.

The evidence of limited concern of IFIs for specifics can be addressed effectively by encapsulating all possible governance disclosure envisaged for IFIs. The present study takes the initiative to contribute by drawing its data from three guidelines/standards issued by the Central Bank of Malaysia, AAOIFI and the IFSB in developing a comprehensive CGD index for IFIs. This is considered an improvement, compared to the index developed by Hameed and Sigit (2005) which may be too narrow in its focus on internal *Shariah* compliance review, social responsibilities for stakeholders, bases for profit allocation between owner equity and IAHs and the Profit Equalisation Reserve (PER).

Closer to the present study, Hassan and Christopher (2005) examined corporate governance disclosures of IFIs in Malaysia. The study was unable to offer an extensive list of governance requirements due to the limited number of governance guidelines which were applicable to IFIs then. The study then concluded that IFIs operate on a different set of rules, on the ground that the most pertinent for IFIs was its need to comply with the requirements of the *Shariah*. Specifically, IFIs have an obligation in meeting the expectations of the Muslim community so as to provide a financing channel that aligns with *Shariah*. As indicated earlier, the expectation of a financial *riba*-free system has

resulted in the importance of Profit and Loss Sharing (PLS) contracts in IFIs' operation. In line with this argument, Hassan and Christopher (2005) infer that IFIs should be selective in their appointment of board members and managers in terms of specific qualification requirements. Emanating from the notions of unity in Islam, universal brotherhood, trust and accountability in the *Shariah*, IFIs are expected to provide greater transparency in disclosure (Hassan & Christopher, 2005).

3. Theoretical Framework

The theoretical framework of this study merely concentrates on the quality of CG information disclosure practised by IFIs in Malaysia. It examines the extent of CG information disclosed by IFIs and the difference of CG disclosure quality between local and foreign owned IFIs in terms of their preference to prioritise the specific or general kind of governance information in their annual reports in the year 2009.² More specifically, the primary objective of this study is to examine the quality of CG disclosures provided by the annual reports of IFIs in Malaysia. Figure 1 below illustrates the research framework.

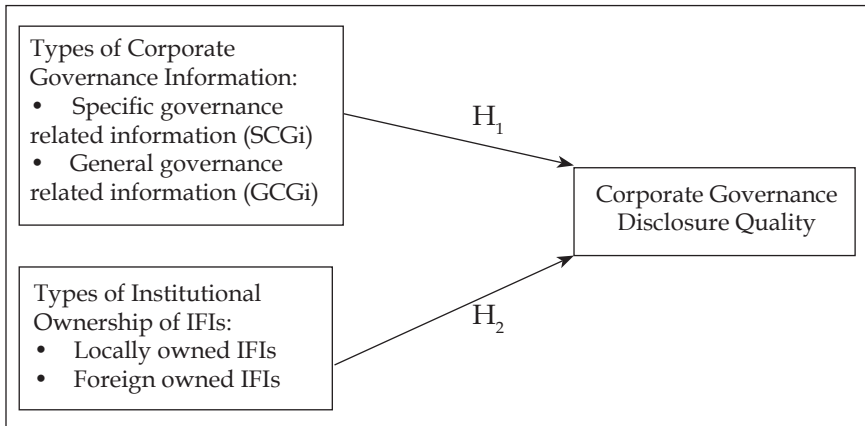


Figure 1: Research Framework

² The study was conducted in late 2010 and the most recent available annual reports were those of 2009.

The theory of interest is the stewardship theory. It is rooted in the sociological and psychological approaches to governance which explains the multiple factors that affect managers' decision making. From the psychological stance, the approach of the theory is to assume that managers, and, by extension, directors, are motivated by things other than narrow self-interest (Nordberg, 2008, p. 37). They have an intrinsic need to be good stewards and their intrinsic satisfaction stems from successful performance. More importantly, from Islam's perspective, the concepts of *Tawhid*, *Khilafah* and brotherhood form the basis of the stewardship theory. Thus, appointed as a board member of a *Shariah* compliant organisation, the steward will carry out his/her duty of a *khalifah* by recognising CG disclosures as part of his/her accountability to fulfill his/her obligations to God and the broader community (*ummah*).

The stewardship theory was chosen as the framework because of the contextual characteristics of IFIs. Contextually, the multifaceted objectives (which focus on more than just economic factors) include having an ideal composition of a board structure supported by strategic board committees - nominating, remuneration, risk management and audit. The good structure of these elements supports proper accounting for risk, effective handling of internal control system, related parties' transactions, an adherence to issued guidelines and the production of various management reports of achieving operational efficiency in IFIs. However, the integration of the PLS mechanism in the basic operation and the ethical conduct of business attached to the *Maqasid al Shariah* (the objectives of Islamic law) (Bhatti & Bhatti, 2009) of the Islamic financial industry has been perceived as being in the best interests of the group rather than for individual financial rewards. As indicated earlier, this context means accountability to a broader group of the community (*ummah*). The essence of *Maqasid al Shariah* substantially curbs any endeavour to acquire wealth by unlawful means, which leads to social inequality and social waste (Bhatti & Bhatti, 2009). As such, the governance structure in IFIs should include the establishment of a *Shariah* and governance committee, the performance of an internal *Shariah* review as an assurance of continuous *Shariah* compliance and the provision of relevant information intended to govern the relationship with IAHs.

The first type of governance information targeted for operational efficiency is common in all kinds of commercial entities. However, the second type of governance information is to provide assurance of continuous *Shariah* compliance in order to achieve the *Maqasid al Shariah*

(the objectives of Islamic law). The concern for both types of governance information by stewards may be seen as an equilibrium response to the wide spectrum of an institution's obligation to commercial and religious affairs. The two types of governance information are: GCGi (general CG information), which is related to institutional efficiency in operation, and SCGi (specific CG information) which is related to the type of activities to protect the proper application of *Shariah* requirements. The SCGi is of particular importance as the philosophy of Islamic financial business dealings which is enshrined by *Shariah*, promotes relatively greater reliance on the PLS modes of financing such as *Mudharabah* and *Musyarakah* (Chapra & Ahmed, 2002, p. 1). In such arrangements, IFIs and their stakeholders (particularly IAHs) become partners in the relationship. In such a relationship, the partnership attributes (i.e. commitment, coordination and trust) and the communication behaviour are vital in determining the success of the relationship between partners.

The stewardship theory emphasises on coordinating the relationship based on trust and personal power (i.e. respect and expertise) (Davis, Schoorman, & Donaldson, 1997). As stewards, the managers and directors of IFIs need to focus on managing the interaction process with their wide array of stakeholders through "increased value commitment and identification" (Davis et al., 1997). This ultimately aims at creating trust and enhancing goal alignment between the IFIs and their stakeholders. The inclusion of CG information in the annual reports, in particular the SCGi, it is argued, is a direct expression of the IFIs for the purpose of gaining the trust of stakeholders. Once confidence is achieved, collaboration is facilitated as it becomes an important lubricant of the social system (Sundaramurthy & Lewis, 2003) between the IFIs and their stakeholders.

The application of a liaison device such as communication also enables firms to establish mutual understanding and cooperation. This is in line with the general theme of Islamic social order, which emphasises on cooperation and mutual consultation (*Shura*) (Sulaiman, 2005). In this regard, the present study proposes that the means of building a shared understanding amongst managers, directors and executives with their stakeholders is through communication. Accordingly, governance concerns (both GCGi and SCGi) about the risks that the IFI's management can assume should be communicated to its regulators and other stakeholders. This approach can provide a basis for dialogue to occur between the firm and its stakeholders, as stakeholders can evaluate if such disclosure matches their risk expectations. Under the

implicit assumption of the stewardship theory, this study hypothesises that the tendency of IFIs is to prioritise on specific kind of governance information as it is considered an expression by IFIs in the attempt to gain stakeholders' trust. Furthermore it is directed to achieve goal alignment based on shared culture and norms which strictly adhere to the requirements of the *Shariah*.

Theoretically, the PLS system practised in IFIs is inextricably intertwined with collectivism spirits promoted in *Shariah* requirements. In this arrangement, the management of an IFI assumes the role of trustee and thus acts in the best interests of the stakeholders in general and the IAHs in particular. Similar claim is made by Bundt (2000, p. 761) in that "the principal-stewardship relationship depends on trust, where trust in this relationship is the expectation that the other will act in good faith in situations in which that party has the power to affect one's own interests". Through the stewardship perspective, this study anticipates that the management of an IFI would voluntarily adopt activities which can enhance stakeholders' trust to collaborate with IFIs.

The underlying ideas in reference to their focus on governance related information is that GCGi is usually pursued with the aim of maximising the financial performance of the IFIs. Meanwhile, the specific-governance information, which may not be directly related to the financial implications for the IFIs, might be important to serve as a basis "to build trust, elicit cooperation and create a shared vision amongst those involved in the firms" (Lewis & Algaoud, 2001, p. 160). As the theory assumes that the steward possesses a high value commitment, Bundt (2000, p. 761) argues that,

"the principal must believe that the steward will make decisions in the best interests of the organization and will be capable of carrying the decisions out. Failure to meet this condition may constrain the steward - either literally by rules and regulations or psychologically by demoralization".

The above is consistent with the concept of *Khilafah* and the argument may partly help to clarify the claim made by Brown and Caylor (2006) who say that governance matters which are unrelated to firm value (in such case, SCGi does not necessarily or directly contribute to economic enhancement), might be of importance for other purposes. For example, in the case of IFIs, their policies are altered to exactly match the intrinsic organisational motivations with their stakeholders' and this

is accomplished by creating a portfolio that focuses on the preferred mix of financial and religious issues in business affairs.

Drawing on a simple steward and principal model, this study hypothesises that firms will be particularly motivated to disclose specific-governance related information as and when they realise that these elements are the antecedents of their trustworthiness to guarantee their accountability towards the fair operation of the banks. Thus, the following hypothesis is formulated:

H₁: IFIs will disclose more specific-governance related information (SCGi) compared to general-governance related information (GCGi).

Additionally, under the implicit assumption of stewardship theory, this study further hypothesises that foreign owned IFIs have a broader group of community (*ummah*). Foreign owned IFIs are likely to make more disclosures relating to governance information. This is because their status to operate on a global level places them in a position to adopt foreign governance guidelines as well as domestic standards which can attract the confidence of stakeholders both at home and abroad. This study argues that foreign owned IFIs will exhibit different levels of compliance according to the Guidelines (hence CGD quality) in order to reflect a governance of different qualities which depends on their operational specificity and motivations. It is further assumed that the roles foreign IFIs play in the global marketplace will also contribute to the disparity of their CGD quality. Currently, the twin roles performed by institutions operating in foreign countries have been identified by Kim, Prescott, and Kim (2005) as that of being a specialised contributor and local implementer. These roles are assumed to have an effect on the stewardship objective of managing the interactions of IFIs with their wider range of stakeholders. Hence, it will impact on the quality of their governance reporting.

In its role as a specialised contributor, foreign banks are highly dependent on the global scale of stakeholders. As is the case, foreign banks may be closely supervised by the headquarters (if they are subsidiaries) or the regulators of their origin countries. In that regard, it is assumed that foreign banks are also subjected to those standards and guidelines applied by the headquarters for control purposes as well as matters pertaining to *Shariah*. Regulators in their origin country may impose rules on foreign banks, which might not be the same as

the rules of the domicile country. In its performance, foreign banks have the tendency to adopt several of these imposed standards besides those called for by domestic guidelines. Given this, it is highly likely that foreign banks provide a higher level of governance information disclosure.

Porter (1986) argues that being a local implementer, foreign banks seek to “meet unusual local needs in products, channels, and marketing practices in each country” (Kim et al., 2005, p. 50). In this respect, this study assumes that foreign banks would attempt to comply with domestic governance guidelines to the best of its ability. This approach is perceived to be an effort made by foreign banks as a way of gaining the trust of local regulators in their competence to cater to local needs. Thus, on the basis of the theory of accountability, one would expect more CG disclosures in the annual reports of foreign owned IFIs than those of local owned IFIs. Accordingly, the following hypothesis is developed.

H₂: There is greater corporate governance information disclosed by foreign owned IFIs than those of local owned IFIs.

As emphasised above, the stand taken in this study is that a greater disclosure of CG information (according to the index) in the finding will be regarded as equivalent to having higher quality CG disclosure.

4. Data Collection and Findings

4.1 *The Corporate Governance Disclosure Index*

A comprehensive corporate governance disclosure (CGD) index was developed by using the guidelines issued by the Central Bank of Malaysia (BNM) in 2007, the standards on CG promulgated by the Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI) in 2008 and the framework introduced by the Islamic Financial Services Board (IFSB) in 2006. In total these yielded 123 items which were then grouped into 14 dimensions as follows. The items in brackets denote the number of items in the dimension:

D1: Board structure and functioning	(D1: 1-24)
D2: Nominating committee	(D2: 25-32)
D3: Remuneration committee	(D3: 33-41)
D4: Risk management committee	(D4: 42-49)
D5: Audit committee/ Audit & governance committee	(D5: 50-61)

D6: <i>Shariah</i> committee/ <i>Shariah</i> Supervisory board	(D6: 62-76)
D7: Risk management	(D7: 77-85)
D8a and 8b: Internal audit and control	(D8: 86-93)
D9: Related parties transactions	(D9: 94-95)
D10: Management reports	(D10: 96-97)
D11: Non-adherence to guidelines	(D11: 98-99)
D12: Customers/ Investment account holders	(D12: 100-113)
D13: Governance committee	(D13: 114-119)
D14: <i>Shariah</i> compliance	(D14: 120-123).

Although there are 14 main dimensions, D8 is sub-classified into D8a and D8b. This is necessary as two items in dimension D8, namely, performance of internal *Shariah* review by internal audit department and a charter of internal *Shariah* review, are specific to IFIs. Hence, these were placed in a sub-category, D8b.

The maximum score which an IFI can achieve is 123 items. The disclosure of all the 123 items will indicate a full compliance with the CGD index. In order to examine if an IFI is actually disclosing items that reflect its unique nature, the 14 dimensions were placed into two specific categories: general-governance related information (GCGi) and specific-governance related information (SCGi). The former (i.e. GCGi) comprises of D1 (Board structure and functioning), D2 (Nominating committee), D3 (Remuneration committee), D4 (Risk management committee), D5 (Audit committee / Audit & governance committee), D7 (Risk management), D8a (Internal audit and control: general-governance information), D9 (Related parties transactions), D10 (Management reports), and D11 (Non-adherence to guidelines). These dimensions are oriented towards the achievement of operational efficiency to lead to an achievement in economic objectives.

The latter, SCGi, consists of D6 (*Shariah* committee/*Shariah* Supervisory board), D8b (Internal audit and control: specific-governance information), D12 (Customers/Investment account holders), D13 (Governance committee), and D14 (*Shariah* compliance). These dimensions extend the orientation towards the realisation of ethical and socially corporate values through the application of partnership-based business principles. The classification into ten dimensions of general-governance related information and five dimensions of specific-governance related information provides an insight into understanding

the type of CG information being disclosed by the IFIs in Malaysia. The SCGi constitutes dimensions that align with the unique characteristics of the IFIs such as *Shariah* compliance, *Shariah* committee, Governance committee (specifically indicated in the IFSB guidelines) and Investment account holders (IAH).

4.2 The Results

The CGD index was developed based on the Guidelines issued between the year 2006 to 2008. In this regard, the 2009 annual reports of all the 16 IFIs located in Malaysia were examined. They comprise ten local owned banks and six foreign owned banks. Content analysis was used to determine the extent an IFI would comply with the index. A score of “1” was given if a particular item was reported and a score of “0” was given if the item was not included in the annual report. A CGD index score, consistent with Pahuja and Bhatia (2010), was then computed using the following formula:

$$\text{CGD Index} = \frac{\text{Total Score of the Individual Bank}}{\text{Maximum Possible Score Obtainable by the Bank}} \times 100$$

Table 1 presents the overall CGD index score of each IFI. The extent of compliance is the proxy for the quality of the disclosure. Thus, the assumption observed in this study is that a greater disclosure of CG information (according to the CGD index) is regarded as having a higher quality CG disclosure. Theoretically, the CGD index could range from zero (0) to 100 per cent. A bank that reports all 123 items will thus score 100 per cent.

As indicated in Table 1, RHB Islamic Bank Berhad has the highest score at 68.29 per cent while Standard Chartered Saadiq Berhad and OCBC Al-Amin Bank Berhad have the lowest score at 42.28 per cent in the year 2009. The highest score for foreign owned IFIs was Asian Finance Bank Berhad at 57.72 per cent. Interestingly, this study finds that foreign owned IFIs have the lowest CGD score. The average score for all IFIs stands at 51.42 per cent which is just above the half way mark. These results reveal that of the 16 IFIs studied, ten IFIs (62.5 per cent) have an index of more than 50 per cent. Wallace (1988) says that a score of more than 50 per cent can be considered as “good disclosers”. Consistent

with this viewpoint, the result of this study is thus deduced as one that projects a picture that can regard IFIs in Malaysia as “good” disclosers of CG information. Further, it is noted that the mean score recorded by locally owned IFIs is at 53.09 per cent which is higher than foreign owned IFIs (48.65 per cent). This evidence seems inconsistent with the expectation in the hypothesis (H_2) which states that CG disclosure quality is better in foreign owned IFIs.

Table 1 : CG Disclosure Quality of the IFIs (N=16)

No.	Names of IFIs	Total Score	Disclosure as % of maximum possible score	Overall Rank
Local Owned Banks				
	RHB Islamic Bank Berhad	84	68.29	1
	Alliances Islamic Bank Berhad	76	61.79	2
	CIMB Islamic Bank Berhad	69	56.10	3
	Bank Muamalat Malaysia Berhad	66	53.66	4
	Hong Leong Islamic Bank Berhad	66	53.66	4
	Public Islamic Bank Berhad	66	53.66	4
	Bank Islam Malaysia Berhad	62	50.41	5
	Maybank Islamic Bank Berhad	57	46.34	6
	EONCAP Islamic Bank Berhad	54	43.90	7
	Affin Islamic Bank Berhad	53	43.09	8
	Total	653	530.90	
	Average score (N=10)	65.3	53.09	
Foreign Owned Banks				
	Asian Finance Bank Berhad	71	57.72	1
	HSBC Amanah Malaysia Berhad	67	54.47	2
	Al Rajhi Banking & Investment Corporation (Malaysia) Berhad	63	51.22	3
	Kuwait Finance House (Malaysia) Berhad	54	43.90	4
	OCBC Al-Amin Bank Berhad	52	42.28	5
	Standard Chartered Saadiq Berhad	52	42.28	5
	Total	359	291.87	
	Average score (N=6)	59.83	48.65	
	Grand total	1012	822.77	
	Average Score (N=16)	63.25	51.42	

This study also examines the extent of reporting made by each IFI on each CG dimension (D1 to D14). A comparison between local and foreign owned IFIs was made. Table 2 presents the results of the overall mean scores for each dimension partitioned by ownership classification of IFIs (i.e. whether local or foreign owned). The rankings for the overall mean scores are given so as to illustrate the relative importance of CG disclosure practices of IFIs. Additionally, a bar chart is included in the appendix for ease of referring to the overall rankings.

As is observed, the overall results of the CG disclosure analysed by dimensions indicate that the most frequently reported elements are D4 (Risk management committee; mean score of 85.16) followed closely by D2 (Nominating committee; mean score of 81.25). Interestingly, information on risk management (D7) has a score of only 54.86; a score that is below that of the risk management committee (85.16). This appears to indicate that while IFIs do have risk management committees, they are not willing to provide as much information on their risk management procedures. Alternatively, this may also signal that there is a lack of proper risk management procedures. This may then be interpreted in the following manner: a well-established risk management committee does not necessarily lead to an enhanced disclosure of risk management issues or clear indications of risk management procedures. The scores for Dimension 8a (Internal audit and control; mean score of 33.33) and Dimension 14 (*Shariah* compliance; mean score of 28.13) are also considerably low. This study finds that the least disclosed dimension is that of Dimension 12 on information pertaining to customers/IAHs (mean score of 2.68).

As is noted, what seems most alarming is the complete lack of information on the governance committee (Dimension 13). The importance of the governance committee (GC) has been emphasised by the IFSB which prescribes a number of characteristics that should be in an effective GC such as having a non-executive director as the chairman of the committee and having a minimum of three members on the committee, namely a member from the Audit committee, a *Shariah* scholar elected by the *Shariah* Supervisory Board (SSB) of the IFI and an independent non-executive director. The IFSB further elaborates on the GC by stating that,

GC whose functions are distinctly different from a conventional audit committee is made particularly because IFIs operate investment accounts which are not in the form of debt contract (as in the case of conventional fixed deposits), thus raising governance issues

which have so far been overlooked. Conceptually, *Mudharib* in the investment account contract comprises both the IFIs' management and shareholders, not only the management.

The lack of information on governance committee may be attributed to the fact that IFIs in Malaysia are generally not putting much emphasis on guidelines issued by the IFSB, preferring to abide closely with the guidelines issued by the Central Bank of Malaysia.

A Mann-Whitney U test was then undertaken to examine if any significant differences exist in the disclosure scores between local and foreign owned IFIs on each dimension. The only significant difference detected (at a 10 per cent level of significance) is for D11 (Non-adherence to guidelines), D6 (*Shariah* committee) and D14 (*Shariah* compliance). For both D11 and D14, it is found that foreign owned IFIs are disclosing more information on CG. This finding partially supports the hypothesis that foreign owned IFIs have better quality CG disclosure. On issues pertaining to the *Shariah* committee, however, this study finds that local IFIs are disclosing more. According to Wallace (1988), the results of more than half of the index score can be classified as "good disclosers". However, given that there are only two items that are significantly different between local and foreign owned IFIs (with foreign owned IFIs showing greater means), it appears that the hypothesis that foreign owned IFIs have better quality CG disclosure (H_2) cannot be fully supported.

The literature advocating CG disclosures in IFIs emphasises the necessity of reporting specific governance information that is unique to their nature such as the internal *Shariah* review and bases for profit allocation between owner equity and IAHs (Hameed & Sigit, 2005). In line with this, the current paper examines the difference between SCGi and GCGi for all IFIs on an overall basis (i.e. all IFIs). However, the analysis for both local and foreign owned IFIs is undertaken separately. Following this, each individual IFI is then examined. The results of these analyses are presented in Tables 2 and 3.

Overall, it may be concluded that IFIs in Malaysia are focusing more on GCGi (60.95 per cent) as compared to SCGi (26.37 per cent) (see Table 2 for more details.) Table 3 shows that the percentage score for GCGi (again on an overall basis) is higher (63.95 per cent) as compared to the score for SCGi (26.37 per cent). This seems to indicate that IFIs place less emphasis on matters related to its specificity (to demonstrate its uniqueness). To examine if the focus on SCGi and GCGi is statistically significant, a Wilcoxon Signed Rank test is undertaken. The results

Table 2 : CG Disclosure of IFIs Partitioned into GCGi and SCGi.

Dimensions	No. of Sub-Items	Overall Mean (N=16)	Overall Mean Rank	Local Owned IFIs Mean (N=10)	Z-value	Sig.	Foreign Owned IFIs Mean (N=6)
GCGi							
D1: Board structure and functioning.	24	66.67	4	69.58	-1.365	.172	61.81
D2: Nominating committee	8	81.25	2	82.50	-1.122	.262	79.17
D3: Remuneration committee	8	69.53	3	85.00	-1.619	.106	43.75
D4: Risk management committee	8	85.16	1	87.50	-0.815	.415	81.25
D5: Audit committee/ Audit & Governance committee	12	62.5	7	60.83	-0.392	0.695	65.28
D7: Risk management	9	54.86	9	53.33	-0.175	.861	57.41
D8a: Internal audit and control	6	33.33	10	33.33	0.00	1.00	33.33
D9: Related parties transactions	2	65.63	5	70.00	-0.484	.628	58.33
D10: Management reports	2	62.50	6	55.00	-1.335	.182	75.00
D11: Non-adherence to guidelines	2	9.38	13	0.00	-1.886	.059*	25.00
Overall for GCGi	81	60.95		60.10		.355	60.37
SCGi							
D6: Shariah committee/ SSB	16	59.38	8	63.13	-1.718	.086*	53.13
D8b: Internal audit and control	2	9.38	12	15.00	-1.441	.150	0.00
D12: Customers/ investment account holders	14	2.63	14	2.10	-0.775	.439	3.50
D13: Governance committee	6	0.00	15	0.00	-	-	0.00
D14: Shariah compliance	4	28.13	11	22.50	-1.890	.059*	37.50
Overall for SCGi	42	26.37		27.07		.151	25.20
Overall for CGD index	123	51.42		53.09		.301	48.64

* A significant difference at the 10 % level (2-tailed).

indicate a significant difference between disclosure on SCGi and GCGi. Similar results are obtained when local and foreign owned IFIs are examined separately. On the basis of this, it may be concluded that H_1 is not supported. In that regard, it may be concluded that IFIs in Malaysia appear to disclose CG information that is of a more generic nature. Further, the percentage of SCGi disclosure made by IFIs ranges from 19.51 per cent (for Bank Islam Malaysia Berhad and EONCAP Islamic Bank Berhad) to 34.15 per cent (for Maybank Islamic Bank Berhad and RHB Islamic Bank Berhad). Thus it may be concluded that CG disclosure of SCGi amongst IFIs in Malaysia is still at a nascent stage. On the other hand, the percentage for GCGi lies within a range of 50 per cent (Affin Islamic Bank Berhad) to 85.37 per cent (RHB Islamic Bank).

Table 3 : The CG Disclosure Score of the IFIs Partitioned by GCGi and SCGi.

No.	Names of IFIs	GCGi (Max. 81 items)	Disclosure as % of maximum possible score	SCGi (Max. 42 items)	Disclosure as % of maximum possible score	Sig.
Local Owned Banks						
	Affin Islamic Bank Berhad	41	50.00	12	29.27	
	Alliances Islamic Bank Berhad	65	79.27	11	26.83	
	Bank Islam Malaysia Berhad	54	65.85	8	19.51	
	Bank Muamalat Malaysia Berhad	54	65.85	12	29.27	
	CIMB Islamic Bank Berhad	58	70.73	11	26.83	
	EONCAP Islamic Bank Berhad	46	56.10	8	19.51	
	Hong Leong Islamic Bank Berhad	57	69.51	9	21.95	
	Maybank Islamic Bank Berhad	43	52.44	14	34.15	
	Public Islamic Bank Berhad	54	65.85	12	29.27	
	RHB Islamic Bank Berhad	70	85.37	14	34.15	
	Overall mean (N=10)		68.10		27.07	0.005***
Foreign Owned Banks						
	Al Rajhi Banking & Investment Corporation (Malaysia) Berhad	53	64.63	10	24.39	
	Asian Finance Bank Berhad	59	71.95	12	29.27	
	HSBC Amanah Malaysia Berhad	55	67.07	12	29.27	
	Kuwait Finance House (Malaysia) Berhad	45	54.88	9	21.95	
	OCBC Al-Amin Bank Berhad	43	52.44	9	21.95	
	Standard Chartered Saadiq Berhad	42	51.22	10	24.39	
	Overall mean (N=6)		60.37		25.20	0.028**
	Total	839	1023.17	173	421.95	
	Average Score (N=16)	52.44	63.95	10.81	26.37	0.000***

Note: *** and ** indicate significance at the 1% and 5% levels respectively (two-tailed).

5. Conclusion

Over the past decade, the corporate governance of Islamic Financial Institutions (IFIs) has moved to serve as the main stream in banking and it is becoming more prevalent in both academic debates and, more generally, the international business media and conference circuit. IFIs pursue two primary objectives: sound financial performance and ethical operations that align with the *Shariah*. More importantly, IFIs exist to serve the needs of the *ummah*. The unique aspect of IFIs emanates from its fundamental principle to conduct and operate in accordance with the *Shariah*, the primary issue being the prohibition of *riba* (interest). Given this, IFIs emphasis on the PLS system. In such a system, transparency becomes a pertinent issue as investment depositors are exposed to the risk of loss. This constitutes a core issue of IFIs which serves to manage the exposed risk that primarily arises because of the absence of protection for investment depositors (Erricco & Farahbaksh, 1998). Corporate governance in IFIs is of utmost importance.

Indeed the fundamental issue addressed in this research is the extent of CG information that is disclosed by IFIs in Malaysia in their annual reports. For the overall basis, the mean score achieved by IFIs is recorded at 51.42 per cent. Based on the benchmark rule set by Wallace (1988), the CG information disclosure noted in IFIs in Malaysia can be considered as "good". This study also finds that the lowest disclosure score is 42.28 per cent (Standard Chartered Saadiq Berhad and OCBC Al-Amin Bank Berhad) and the highest disclosure score is 68.29 per cent (RHB Islamic Bank Berhad). This may possibly be due to the fact that RHB Islamic Bank Berhad is controlled by Muslims³ (thus resulting in a higher score) while Standard Chartered Saadiq Berhad and OCBC Al-Amin Bank Berhad are controlled by non-Muslims⁴.

A possible explanation for the low scores can be attributable to the fact that all three guidelines were only issued quite recently (the IFSB issued its guidelines in 2006, the Central Bank of Malaysia in 2007 and AAOIFI promulgated its standards in 2008). Given that the study was conducted in late 2010 (focussing on 2009 annual reports), the impact of the guidelines/standards on CG disclosure practices may not be

³ This assumption is drawn from the fact that RHB Islamic Bank Berhad is a subsidiary of a local bank whose major shareholders are the Employees Provident Fund (Malaysia) and ADCB Holdings (Malaysia) Sdn Bhd. The latter's ultimate holding company is Abu Dhabi Commercial Bank PJSC (RHB Capital Berhad's Annual Report 2010).

⁴ Standard Chartered Saadiq Bank Berhad and OCBC Al-Amin Bank Berhad are subsidiaries of foreign banks headquartered in London and Singapore respectively.

significant at the time the research was undertaken. Further, the fact that there might not be any negative consequences of non-compliance may also explain the less than satisfactory CG disclosure scores.

To sum up, it can be said that even if the intrinsic objectives that characterise the 'best practices' governance have not been perfectly attained yet, CG orientation in IFIs seems to converge on a pool of ethical and socially responsible issues which are wider than those in the generic industry. This claim can be traced back to the 14 dimensions covered in the annual reports of IFIs. As may be recalled, D1 (Board structure and functioning), D2 (Nominating committee), D3 (Remuneration committee), D4 (Risk management committee), D5 (Audit committee/ Audit and governance committee), D7 (Risk management), D8a (Internal audit and control on general governance information), D9 (Related parties transactions), D10 (Management reports), and D11 (Non-adherence to guidelines) oriented towards the achievement of operational efficiency which aims to lead to an accomplishment in economic objectives, while D6 (*Shariah* committee/ *Shariah* Supervisory board), D8b (Internal audit and control on specific governance information), D12 (Customers/ Investment account holders), D13 (Governance committee), and D14 (*Shariah* compliance) extend the orientation towards the realisation of ethical and socially corporate values through the application of partnership-based business principles.

For the overall CG disclosures of IFIs for year 2009, eight dimensions were noted to be dominant. The order they lie are D4 (Risk management committee), D2 (Nominating committee), D3 (Remuneration committee), D1 (Board structure and functioning), D9 (Related parties transactions), D5 (Audit committee/ Audit and governance committee), D10 (Management reports) and D6 (*Shariah* committee/ *Shariah* Supervisory board).

The analysis tests the first hypothesis concerning whether IFIs are actually disclosing more SCGi (i.e. D6, D8b, D12, D13 and D14). The expected strategy of CG structure in IFIs is that they must give due consideration to specific kinds of governance dimensions, which come together to compose the 'best practice' CG in the institution. The results, however, reveal that the formulated hypothesis is not fully supported. IFIs in Malaysia generally disclose more GCGi. Accordingly, IFIs are not particularly motivated to disclose specific-governance related information although on the basis of the stewardship theory, these elements reflect the accountability aspects of IFIs towards stakeholders. Further, the stewardship theory posits that managers and directors of

IFIs need to provide CG information in their annual reports, particularly the SCGi in order to gain the trust of stakeholders.

The considerations above allow this study to conclude that at the time this study was undertaken, IFIs tended to converge on general-governance related information – more related to information pertaining to risk management committee (RMC) and nominating committee (NC). It can thus be interpreted that the major concern for IFIs at the time of this research was in addressing various risks and hiring persons with the credentials to lead the institutions. Of less concern to the IFIs is the disclosure of general-governance information pertaining to the non-adherence to guidelines (9.38 per cent) and information pertaining to the specific kind of governance information, such as the information relating to *Shariah* compliance (28.13 per cent), the specific part of internal audit and control (9.38 per cent), and customers/IAHs (2.63 per cent). While information on governance committee is not a concern for any of the IFIs, other information (in order of preference) on remuneration committee, board structure and functioning, related parties transactions, audit committee/AGC, management reports, *Shariah* committee/SSB and risk management are satisfactorily disclosed by IFIs (with scores more than the 50 per cent threshold). The provision of information on the general part of internal audit and control and *Shariah* compliance is noted to be minimal.

The analysis shows that IFIs seem to be in agreement about what structure should be set in the institution. The lack of SCGi disclosure may be attributed to deficiencies in the prevalent CG reporting framework and to the attitudes of IFIs management concerning the perceived costs and benefits of CG disclosures. Nevertheless, the presence of such information (however minimal) in the annual reports of the IFIs is an indication of a growing awareness of the importance of this type of governance information. The limited supply of specific-governance information in the annual report of IFIs may possibly indicate that this kind of information is uncommon. However, disclosure through other means such as companies' websites and pamphlets cannot be discounted.

The results, however, should be interpreted in light of certain limitations. First, the small number of IFIs considered in this study is a limitation in itself. Future studies should, therefore, attempt to include IFIs in other countries. Further, given that the comprehensive CGD index developed here has also incorporated guidelines/standards issued by two international bodies, namely the IFSB and AAOIFI, empirical work in other countries could test the robustness of the index.

Second, is the use of cross sectional data that merely examines evidence based on patterns at a particular moment as opposed to observing the changing levels of compliance over time (thus ignoring the trend of CG disclosure over time). Accordingly, a longitudinal study in the future may address this limitation. Third, each item in the CGD index in this study is assumed to have equal importance. However, this may not be necessarily so. Thus, the application of a weighted approach for the items in the CGD index would greatly improve the index.

The fourth limitation is the focus of just the three Guidelines: BNM/ GP1-i (2007), IFSB-3 (2006) and GSIFI (2008) in developing the CGD index. However, as indicated in the earlier part of this paper, the three Guidelines were chosen primarily because they effectively encapsulate all of the governance disclosures envisaged for IFIs. More importantly, these three Guidelines were issued by three very influential organisations in the area of Islamic banking and finance in Malaysia. Future studies may want to include recommendations from other sources such as the Malaysian Code of Corporate Governance (MCCG) and the Listing Requirements of Bursa Malaysia. Finally, the use of content analysis raises a methodological limitation to the analysis. However, according to Florou and Galarniotis (2007), content analysis of annual reports and web pages are expected to produce less subjective governance ratings as compared to self-completed questionnaires. Yet another alternative would be the use of semiotic analysis. Essentially, semiotics is a study of the structure and meaning of language reducing textual data to their component parts without losing its meanings. More importantly, while content analysis refers to a quantitative approach to textual analysis, semiotic analysis represents a qualitative method in examining non-numeric data (Murphy, 2007).

This study provides insights into the CG quality in both locally owned and foreign owned IFIs in Malaysia. In both instances, there is no legal requirement for an IFI to adopt the suggested governance guidelines and yet this study finds some evidence which indicate that they do so voluntarily. In addition, the overall qualities to which voluntary governance guidelines are implemented are considered as satisfactory as these meet more than half of the items in the CGD index developed. Nascent development is also detected on the existence of the disclosure on the specific-governance related information.

The challenge placed before IFIs today is to improve all crucial aspects of CG that are unique to them as in the specific CG information that have been suggested in this study. More specifically, IFIs should focus on information pertaining to the *Shariah* committee/SSB, specific

matters on internal audit and control, customers/IAHs, detailed information on governance committees and *Shariah* compliance aspects. Various banking crisis, over time, have dramatically illustrated the catastrophic consequences following from the poor corporate governance of banks (Yunis, 2007). To provide a cushion against these flaws, there is a need to have a rigorous re-evaluation of CG principles of IFIs. This is important as CG may be regarded as a key factor in understanding the institution and its management. Good CG is pertinent as this will enhance investor confidence in the decision taken by the managers and board of directors of the institution (Gandia, 2008) - more so in the case of IFIs.

The *Shariah* Governance Framework for IFIs issued by the Central Bank of Malaysia in 2010 (and effective from 2011 onwards) may well address the lack of transparency on specific governance related matters that are pertinent to IFIs. Specifically, the framework outlines the *Shariah* governance structures, processes and arrangements of IFIs in order to ensure that all its operations and business activities are in accordance with *Shariah* rulings. Additionally, the framework also provides a comprehensive guidance to the board, committee and management of the IFI in discharging its duties to accord with the dictates of the *Shariah*. Finally, the framework spells out, in no uncertain terms, the functions related to *Shariah* review, *Shariah* audit, *Shariah* risk management and *Shariah* research. With this set in mind, it can be said that the framework “tightens” the corporate governance practices of IFIs that are operating in Malaysia. Most importantly, if IFIs adhere to the framework, it is thus, in their best interests, to disclose. Accordingly, future research should examine the impact of the framework on corporate governance disclosures of IFIs.

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APPENDIX 1

CG Disclosure Practices of IFIs in Malaysia.

