

Financial Reporting Quality among Non-Profit Organisations in Malaysia

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The rising numbers of public fund mismanagement and corruption cases reported in Malaysia require the organisations to provide quality and transparent financial reporting to hedge them from becoming part of the statistic. Thus, although it is not required by the standards, it is vital for Non-profit organisations (NPOs) to provide a quality financial report to give their stakeholders sufficient and accurate information about the organisations' activities and financial performance. Therefore, the purpose of this study is to review the content of Zakat Institutions (ZI) annual reports to analyse the current practice. To accomplish this, we reviewed a sample of annual reports from 14 ZIs in Malaysia which are publicly available. Content and descriptive analysis methods were utilised in analysing these annual reports. Based on the analysis conducted, the major difference in the reporting practices of ZI's annual reports is due to the inconsistency of information disclosed specifically regarding a financial matter.

Key words: *Annual reports, non-profit organisations, Zakat institutions, reporting practices.*

Introduction

Financial scandals, frauds and misrepresentations of financial reporting highlighted these days has urged the organisation to provide prudent and transparent reporting. The poor preparation of annual reports by NPOs has come under debate among researchers (Jamila and Alhabshi, 2019) due to its tendency to lead to major mismanagement issues. This is when insufficient information provided may hide any major problems that exist in the organisation. Adams (2017) and Costa & Goulart da Silva (2019) agreed that NPOs need to look for ways to ensure the integrity of their annual reports since stakeholders require product quality information to be included in the annual report of NPOs to facilitate them in the decision-

making process. Stakeholders are not limited to the contributors, members, grant providers, government and includes the public at large (Dekker, 2018).

Although transparent and prudent financial reporting is a crucial issue to be highlighted, there is a scarcity of research available pertaining to this issue. Cordery et al., (2019) highlighted several reasons for the scarcity of research that covers the financial disclosures or annual reports of NPOs. This includes a lack of readily accessible financial and annual reporting by NPOs, which hinders the researcher to embark on such a topic. According to Morris & Tronne (2018), the annual report was meant to provide the past year records of the organisation's performance and achievements. To make it meaningful, annual reports should be relevant, understandable, reliable and comparable (Morris & Tronnes, 2018). More importantly, annual reports must contain information on the organisation's financial position that can be used to measure their growth over years (Ben-Amar & Belgacem, 2018) so that stakeholders may get reasonable knowledge about the business and its economic activities (Azar et al., 2019).

It cannot be argued that transparent and comparable annual reporting is essential to portray the efficiency of organisations (Fraser and Lee, 2016). To ensure this, a descriptive analysis of NPO reporting practices could identify what is being reported and how well it adapts to accounting information (Crawford et al., 2018). Considering the importance of this issue, this study was conducted to review the content of NPOs annual reports, and to be specific Zakat Institutions (ZIs). To accomplish this, the annual reports which are publicly available on the website of ZIs from 14 states have been selected. ZIs are commonly chosen by researchers due to their unique characteristics which are governed by their rules and usually information produced by such institutions cannot be treated as confidential. Among the limitations faced by prior researchers in conducting studies on ZIs are difficulties in obtaining the relevant data regarding ZIs reporting (Htay & Salman, 2014; Sulaiman et al., 2015; Sapingi et al., 2017; Samargandi et al., 2018).

In brief, the results of this study reveal that the reporting practices among ZIs in Malaysia vary in each state. The overall content usually consists of a non published annual report, description on the ZI's past year activities, and an overview of the ZI's mission, objectives and their success stories. The financial data disclosed in the annual reports range from no information to a complete set of audited financial statements. The results show that there is no uniformity in the way ZIs reported their financial statements, confirming that no requirements or proper guidelines caused discrepancies in the reporting. This might result in difficulties by the public to make any comparison especially on how ZIs manage the collection and distribution of the Zakat fund which usually is the main focus nowadays.

The remainder of this paper is organised as follows: description of the regulatory environment for annual reporting of NPOs; research methodology used to capture the depth of NPOs information disclosure of ZIs; discussion of the study that covers the detail findings; and the final section provides a summary, concluding comments and suggestions for future research.

Regulatory Environment for Annual Reports of Non-Profit Organisations in Malaysia

NPOs in Malaysia are in the form of either a charitable corporation or a society. The societies, which are registered, monitored and controlled by the Registry of Society (ROS), are governed by the Societies Act 966 and Societies Regulations 1984 within the Ministry of Home Affairs. The main statutes dealing with the establishment and regulation of NPOs in Malaysia are the Societies Act 1966 (Act 335), Societies Regulations 1984, and the Income Tax Act (ITA) 1967 issued by the Inland Revenue Department (IRD). Some NPOs may register under specific acts (e.g. the Sports Commission Act, the University and University Colleges Act 1971, and Youth Commission). Otherwise, they can register themselves under the Companies Act. NPOs in the form of a company are incorporated as companies limited by guarantees (known as “charitable corporation”) and are governed by the Companies Act 2016 (prior to 1965).

The organisations registered under ROS are required to comply with Section 14(d) of the Societies Act 1966 (Act 335) and Societies Regulations 1984. In addition, they also are encouraged to comply with the Malaysian Financial Reporting Standards (MFRS) issued by Malaysian Accounting Standard Board (MASB) although it is not compulsory to audit the financial statements to ensure that they are transparent and being audited on a voluntary basis. Cash flow statements, statement of changes in general funds, notes comprising a summary of significant accounting policies, and other explanatory notes, which supplement financial statements, are not required by the ROS. On the other hand, NPOs registered under CCM are required to comply with the MFRS and financial statements must be audited. This requirement is similar to private entities in Malaysia where the essential components of information are disclosed and distributed to stakeholders. As a result, most NPOs now prepare a single annual report which delivers both the compliance and communication objectives of external reporting. These help stakeholders to obtain common reporting elements such as: management letters; management discussion and analysis; description of business lines; consolidated financial statements with notes and audit report; and supplementary charts and schedules.

Given the difference in the reporting environment of NPOs in Malaysia, few researchers have provided guidance on the content and preparation of NPOs annual reporting. Htay & Salman (2014) stated that there are no guidelines issued for the financial reporting aspects of ZIs.

Therefore, they proposed best practice for ZIs financial information disclosure. Using questionnaire and document analysis methods, they concluded that the essential components of reporting are: disclosure on Zakat collection and distribution; information on activities statements; beneficiaries comparative collection and disbursement statements; and information on the board of trustees.

On the other hand, Nelson et al., (2017) have developed disclosure items for ZIs. Their research involved four prevalent stages of determining disclosure items; these are previous literature, reviews from a panel of experts, pilot survey and questionnaire. Nelson et al., (2017) identified the key areas for information disclosure in annual reports. The four main areas comprise the institution's background information, governance information, financial information and non-financial and performance information. The background information consists of three-sub areas which are core values, contact address and corporate governance. Meanwhile, governance information consists of two-sub areas which are corporate governance activities and financial accounting information. On the other hand, financial information consists of the three-sub areas i.e. other financial information, financial statement and Zakat collection and disbursement. In contrast, non-financial and performance information covers the information on Zakat recipients, a summary of activities and awareness programs. The findings of their research have come out in the disclosure items that are necessary to be included in ZIs annual report.

Research Methodology

Data was collected from the annual reports of ZIs that is available at their websites and webpages from 2014 until 2018 as listed in Table 1. The annual reports collected were analysed by using the content analysis method.

Table 1: Zakat Institutions Website/Webpage for Each States in Malaysia.

States	Website	Webpage
Johor	-	maij.gov.my/zakat
Kedah	zakatkedah.com.my	-
Kelantan	-	e-maik.my/zakat
Melaka	-	maim.gov.my/zakat
Negeri Sembilan	zakatns.com.my	-
Pahang	zakatpahang.my	-
Pulau Pinang	zakatpenang.com	-
Perak	-	maiamp.gov.my/zakat
Perlis	-	maips.gov.my/zakat
Selangor	zakatselangor.com.my	-
Terengganu	-	maidam.gov.my/zakat
Sabah	zakatsabah.gov.my	-
Sarawak	tbs.org.my	-
Wilayah Persekutuan	zakat.com.my	-

Source: Website/Webpage for Each States in Malaysia (2020).

Table 2 provides the list of ZI's websites and webpages which are used to obtain published annual reports of ZIs. Based on the review of each website and webpage, the study found that nine states (Johor, Melaka, Negeri Sembilan, Pahang, Pulau Pinang, Perlis, Terengganu, Sabah and Sarawak) did not publish their annual reports for public view from 2014 until 2018. Kedah only published its annual report in 2015 and 2016, while Kelantan and Perak published their annual reports in 2014 until 2016 and Perak 2015 until 2017. Meanwhile, two states (Selangor and Wilayah Persekutuan) have consistently published annual reports on their website every year.

Table 2: Zakat Institutions Annual Report and Financial Statement Published on Website / Webpage from 2014-2018.

State	Year				
	2014	2015	2016	2017	2018
Johor	x	x	x	x	x
Kedah	x	/	/	x	x
Kelantan	/	/	/	x*	x*
Melaka	x	x	x	x	x
Negeri Sembilan	x	x	x	x	x
Pahang	x	x	x	x	x
Pulau Pinang	x	x	x	x	x
Perak	x*	/	/	/	x*
Perlis	x	x	x	x	x
Selangor	/	/	/	/	/
Terengganu	x	x	x	x	x
Sabah	x	x	x	x	x
Sarawak	x	x	x	x	x
Wilayah Persekutuan	/	/	/	/	/
Total	3	5	5	3	2

Notes: *Only published financial statement

Source: Website/Webpage for Each States in Malaysia (2020)

The Disclosure Informations in Annual Reports

As mentioned earlier this study analysed annual reporting of each ZI and disclosure items based on Nelson et al., (2017). The four categories are; (1) Background information (directors background, core values, contact address); (2) Governance information (corporate governance, corporate governance activities); (3) Financial information (financial accounting information, other financial information, financial statement); and (4) Non-financial and performance information (collections and disbursements, recipients, summary of activities, awareness programmes) which were derived from an initial review of annual reports. For this study, only two disclosure items for each subcategory were selected from Nelson et al., (2017) to analyse as shown in Table 3.

Table 3: Disclosure Items for Zakat Institutions.

Code	Items	Code	Items
B1	Director's background	F2	Other financial information
B11	Name of chairman/president/director	F21	Total Zakat collection for the year
B12	Name of Board of Directors/ Board of Trustees	F22	Total Zakat disbursement for the year
B2	Core values	F3	Financial statement
B21	Vision statement	F31	Statement of financial position
B22	Mission statement	F32	Cash flow statement
B3	Contact address	N1	Zakat collections disbursements
B31	The address of the registered office of the Zakat Institution	N11	Information on the last year's Zakat collection
B32	Contact information of the zakat Institution	N12	Information on the last year's Zakat disbursement
G1	Corporate governance	N2	Zakat recipients
G11	Audit Committee composition and their profile	N21	Assessment criteria to be qualified as Zakat recipients (e.g. gross family income)
G12	Summary of activities of Audit Committee in a year (review the results of the audit)	N22	Disclosure on means of Zakat application to ask for Zakat
G2	Corporate governance activities	N3	Summary of activities
G21	Number of meetings attended by the Board of Directors/Board of Trustees	N31	Summary of Zakat collection and disbursement
G22	Period of appointment of Board of Directors/Board of Trustees	N32	Summary of Zakat surplus by the end of each year (Graph, charts etc.)
F1	Financial accounting information	N4	Awareness programs
F11	Adopted accounting standards or guidelines	N41	Awareness program for Zakat payers
F12	Accounting policy adopted	N42	Awareness program for Zakat recipients

Source: Nelson et al., (2017)

By analysing these items, the study provides some initial insight into what is disclosed by NPOs and who they perceive as their relevant customers. A thorough analysis has been conducted to identify the existence of four categories of financial statement as per stated by Nelson et al., (2017). The results are reported in Table 3. This table shows the categories and items that are used in this study to analyse annual reports of ZIs from each state based on the selected annual report published on ZI websites or webpages.

Table 4 presents an overview of the annual reports of ZIs in Malaysia. There are five states that have published at least one annual report through their website or webpage. Of these, Perak is the state with the highest disclosure of annual reporting items with 19 items followed by Kelantan (17), Kuala Lumpur (15), Selangor (14) and Kedah (10). Out of the 24 disclosure items, a total of 10 items were disclosed by all states. On the other hand, only Kelantan and Perak disclosed a full set of financial statements (F31 and F32) whereas Kedah, Selangor and Wilayah Persekutuan only disclosed financial accounting information (F21 and F22).

Table 4: Description of Annual Reports of Zakat Institutions.

Categories	Sub-Categories		States				
			Kedah	Kelantan	Perak	Selangor	Wilayah Persekutuan
Background Information	B1	B11	/	/	/	/	/
		B12	/	/	/	/	/
	B2	B21	x	/	/	/	/
		B22	x	/	/	/	/
	B3	B31	x	/	/	/	/
		B32	/	/	/	/	/
Governance Information	G1	G11	x	x	/	x	/
		G12	x	x	x	x	X
	G2	G21	x	x	/	x	/
		G22	x	x	x	x	X
Financial Information	F1	F11	x	/	/	x	X
		F12	x	/	/	x	X
	F2	F21	/	/	/	/	/
		F22	/	/	/	/	/
	F3	F31	x	/	/	x	X
		F32	x	/	/	x	X
Non-Financial and Performance Information	N1	N11	/	/	/	/	/
		N12	/	/	/	/	/
	N2	N21	x	x	x	/	X
		N22	x	x	x	x	X
	N3	N31	/	/	/	/	/
		N32	x	x	x	x	X
	N4	N41	/	/	/	/	/
		N42	/	/	/	/	/

Source: Website/Webpage for Each States in Malaysia (2020).

The most disclosure items were non-financial and performance information items namely N11, N12, N31, N41 and N42 followed by background information with three items (B11, B12 and B32) and two financial information items (F21 and F22). However, there were four items not disclosed by any state which were: summary of activities of Audit Committee in a Year (G12); period of appointment of Board of Directors/Board of Trustees (G22); disclosure on means of Zakat application (N22); and summary of Zakat surplus by the end of each ear (N32).

Summary and Conclusions

The variety of disclosure information in annual reports showed there is no uniformity between ZIs in Malaysia. If the information is not clearly disclosed to the public, this can lead to the misperception on the way Zakat money was managed by the institutions. As noted earlier, each state has its own policies in disclosing information. However, the management should ensure that the information provided was sufficient, relevant and accurate. Overall, ZI annual reports appear to be more than just a public relations document designed to recognised and encourage Zakat payers. ZI annual reports address the institutions annual financial activities and condition.

The descriptive analysis used to assess the content of ZI annual reports found an essentially unregulated reporting environment. As outlined in Table 4, the great variety of information disclosure reveals a diversity of interpretation that is not found in a for-profit organisation environment. The table shows that each state's annual reporting varies according to each state's policies of disclosing information. This might be due to the fact that the administration of Zakat in Malaysia is under the jurisdiction of each state or the authority of the state government (Sultan) except the Federal Territory where Zakat and administration laws are managed by the Federal Government (Esa et al., 2017).

This study documents an extensive lack of consistency in the financial disclosures found within 14 sets of ZIs annual reports. This study found that some annual reports contained no financial information while others provided complete financial statements, notes and audit reports. The results show that these varieties are due to the different policies of each state in information disclosure.

Limitations and Trends of Future Research

The results of this study are limited in that they address only annual reports published on websites/webpages and not the hardcopy itself. In addition, the results may suffer from non-available bias since a few ZIs did not publish annual reports online. This unavailability suggests several additional research issues: why the annual reports are not published on the



websites/webpages?; what factors influence the ZIs to not published annual reports on their websites/webpages and what is included in those reports?

Future research is also needed to examine the annual reports of other NPOs to determine if there are differences in the disclosure practices of those organisations, as well as among organisations that are unwilling or unable to provide annual reports. Finally, the quality of financial disclosures and how other data meets user needs, present important opportunities for future study.

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