



THE IMPACTS OF INTERNAL CONTROL PRACTICES ON FINANCIAL ACCOUNTABILITY IN ISLAMIC NON-PROFIT ORGANIZATIONS IN MALAYSIA

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ABSTRACT

This study aims at examining the impacts of internal control practices on financial accountability in Islamic non-profit organizations (NPOs) in Malaysia. Thus, this study applies an explanatory case study method to analyze intervention of life events which form the internal control practices. For data collection, this study used a shorter case study interview with interview protocol questions developed from the literature review. For reporting, this study adopted a multiple-case study format combining all three cases into a single report. As a result, this study identified significant interrelation impacts between internal control practices and financial accountability by Islamic NPOs in Malaysia under three aspects: (i) financial accountability ‘for what’ – internal control as part of financial accountability process; (ii) financial accountability ‘on how’ – internal control discharged financial accountability through financial disclosure; and (iii) financial accountability ‘to whom’ – internal control supports Islamic NPOs to gain both power (*khilāfah*) and trust (*amānah*) from stakeholders. Therefore, this study is among the few studies that examine the internal control practices especially their impacts on financial accountability of Islamic NPOs in Malaysia.

JEL Classification: M41

Keywords: Internal control, Islamic non-profit organization, Financial accountability, Islamic social accounting

1. INTRODUCTION

Internal control practices are important to every organization including Islamic non-profit organizations (NPOs). Regardless of the degree of importance, internal control practices become one of the elements in ensuring an organization is operating well. Besides, NPOs need good operations management to assure their stakeholders. This is because NPOs depend on public donations. Thus, it is vital to have good internal control practices, especially financial management to ensure organizational sustainability.

Most of the Islamic NPOs are being heavily funded by the public. These funds are known as the Islamic charity funds and come in in various forms such as *sadaqah*, *waqf*, and *zakāt*. Funds contributed can be in terms of cash and goods. Jon, Hunter, and Ann (2005) estimated the Muslims' contribution in terms of Islamic charity funds is within USD250 billion to USD1 trillion per year. Meanwhile, Obaidullah and Shirazi (2015) stated that there is an excess of about USD600 billion of *zakāt* from the Organization of Islamic Cooperation (OIC) member states, which may be annually distributed for humanitarian relief.

The huge amounts of money involved eventually will create problems especially in the collecting, managing and distributing processes. Several previous studies such as Greenlee et al. (2007), Hees, Ahlendorf, and Debere (2010), Siino (2004) and Vanderwarren (2001) identified many cases of abuse and misconduct involving religious charity funds that give negative public perception especially regarding the NPOs' accountability. As part of religious charity funds, Islamic charity funds also need to assure donors regarding their management practices, especially in collecting, managing and distributing funds. One way to ensure good management of Islamic charity funds is by having proper internal control practices. Therefore, we need to identify and evaluate the impacts of implementing internal control practices on financial accountability in Islamic NPOs.

It is also believed that issues arise in implementing the internal control practices in Islamic NPOs. This is attributed to the unique characteristics of NPOs themselves such as: absence of ownership; no specific financial disclosure standards aligned with non-profit objectives and goals; commonly managed by a group of people who are only expert in non-profit services and also possess little knowledge on accounting or finance by NPOs' BOD (Duncan, Flesher, and Stocks, 1999). Besides that, NPOs including Islamic

NPOs have inherent limitations for internal control practices such as often including repetitive tasks with the rare occurrence of exceptional operations, only preferable if benefits of internal control exceed costs and also heavy dependence on competence and confidence of the person in-charge (Daniela and Attila, 2013). These unique characteristics and inherent limitations for internal control practices are believed to generate several issues in implementing good internal control practices including for Islamic NPOs.

Thus, this paper focuses on the impacts of internal control practices by three Islamic NPOs with humanitarian relief objectives in Malaysia. These three Islamic NPOs known as Institution A, Institution B and Institution C are registered as the Company Limited by Guarantee (CLBG) category with the Companies Commission of Malaysia (CCM). In Malaysia, NPOs with revenue exceeding RM1 million per annum are normally registered as CLBG. This type of NPO is legally bound by the Companies Act of 1965. CLBG is one of four main types of NPOs in Malaysia; the three other CLBG types are foundations, societies, and associations.

In the next section, this paper discusses the literature review on the importance of internal control practices and the impact of internal control on accountability. Then, it continues with the research objective and design. Next, the discussion on findings briefly explains the impacts of internal control practices on financial accountability in Islamic NPOs in Malaysia. Finally, a conclusion is made about the importance of internal control practices in Islamic NPOs in Malaysia based on discussion of findings.

2. LITERATURE REVIEW

2.1 THE IMPORTANCE OF INTERNAL CONTROL PRACTICES

Internal control has become one of the important components of financial management practice in every organization. This is because internal control functions in controlling all possible risks, coordinates organizational activities accordingly and assists in managerial decision-making (Devi, Hooper and Davey, 2007). Good internal control practices will lead to achieving all three objectives as stated in the *Internal Control – Integrated Framework*, which are: (i) reliability of financial reporting; (ii) effectiveness and efficiency of operations; and (iii) compliance with applicable laws and regulations (COSO, 2013).

For the first internal control objective, it is believed that reliability of financial reporting is closely related with the reliability theory. This theory is a way of thinking that evaluates the quality of information by measuring the procedures invented to obtain such information (Traub, 1994; Mock and Turner, 2013). In this case, it is believed that having a good internal control practice will give accurate and unbiased financial information (Shiri et al. 2012; Siraj, 2012; Spitzer, 2005). Good internal control practices will detect and prevent any possible errors that will cause a misstatement in financial information (Doyle, Ge and Mcvay, 2007). For the NPO, reliable information derived from appropriate internal control practice will positively affect donor contributions (Arshad et al., 2012; Petrovits, Shakespeare and Shih, 2011). Internal control practice also ensures NPOs utilize their financial resources according to best practices (Sulaiman, Siraj and Ibrahim, 2008).

Meanwhile, the second internal control objective which is effectiveness and efficiency of operation is supported by decision theory. This theory is about a process in making a resolution for future benefits supported by adequate information (Reddy, 2004). In this case, good internal control practice will assist decision-making by providing more accurate and reliable financial information (Kinney, 1975). Abbas and Iqbal (2012) stated that internal control practice needs continuous monitoring to support reliable decision-making especially on financial matters. For the NPO, internal control practices will ensure operations conducted comply with the standards and guidelines set by the organization itself (Spillan and Ziemnowicz, 2011). Internal control practices also require NPOs to report to the authority/superior regarding expected activities and programs results (Srinivas, 2014). Both the board of directors (BOD) and the management of NPOs are responsible for internal control practices (Huse, 2005; Kumar and Nunan, 2002; Vanderwarren, 2001; West and Zech, 2007). This is because the BOD and the management have the capacity to monitor the organization's operations and they also are the key decision makers (Eisenberg, 1997).

The third internal control objective, which is compliance with applicable law and regulation seems to be related with legitimacy theory. Legitimacy theory suggests that NPOs operate within societal norms (Talet, 2014). In this case, the NPO needs to ensure that it operates according to government standards and guidelines. By complying with the rules and regulations through stringent internal control practices the organization will increase

public confidence in itself (Siraj, 2012). This happens as the public believes that internal control is vital for better management in NPOs (Anthony and Young, 1999).

These three internal control objectives also are supported by several professional bodies, including the International Federation of Accountants (IFAC) and the Government Finance Officer Association (GFOA). IFAC in the *Professional Accountants in Business Committee International Good Practice Guideline* highlights that internal control should be used to support the organization in achieving its objectives by managing its risks, while complying with rules, regulations, and organizational policies by treating internal control as part of risk management and integrating both in its overall governance system (IFAC, 2012). Meanwhile, GFOA in its *Enhancing Management Involvement with Internal Control* mentioned that good internal control practice is required in maintaining reliable systems, ensuring timely preparation of reliable information, safeguarding assets, optimizing resource use and preventing and detecting error and fraud in an organization (GFOA, 2004). Therefore, it can be concluded that internal control practices are crucial including for NPOs.

2.2 THE IMPACT OF INTERNAL CONTROL ON ACCOUNTABILITY

Literature review suggests that one issue concerns the internal control impact on accountability especially in the religious NPOs around the world. For example, Fonfeder, Holtzman, and Maccarrone (2003) who investigated internal control practices in the Jerusalem Temple found that improper record keeping practices where it only focused on cash record, makes the temple unable to utilize all financial resources gathered. Besides, the Shaibu (2013) study on internal control practices in three Greater Accra churches identified some weaknesses such as absence of office or specific place for clerk accounts to collect and manage charity funds leading to the tendency of charity fund loss. A study on 10 state mosques in Malaysia by Sulaiman et al. (2008) exposed that the lack in staffs' and committees' knowledge of adequate internal control practices and unstandardized financial reporting contributed to the weaknesses in internal control. Ironically, all these three previous studies summarized similar causes due to the weaknesses in internal control

practices which are accountability issues affecting public trust in the organizations.

Besides, several another previous accountability issues due to the weakness of internal control practices in NPOs. This includes charity fund embezzlement cases of the Archdiocese of San Francisco and Pittsburgh pastor (Siino, 2004); misuse of public fund case by the United Way of America (Vanderwarren, 2001); and a few more similar cases by Greenlee et al. (2007). Malaysia also witnessed a few accountability issues in NPOs such as 39 reports on manipulation and misappropriation of public funds during flood crises in 2014 received by the Malaysia Anti-Corruption Commission (MACC) (Astro Awani, 2015); allegation and negative perception regarding spending method became one of the factors for the cancellation of contributions by 32,934 regular donors to Yayasan Pembangunan Ekonomi Islam Malaysia (YAPEIM), an Islamic organization in Malaysia from February 2015 until February 2016 (Teng, 2016); several Islamic non-profit organizations in Malaysia being accused of involvement in terrorism financing (Kamaruddin, 2016; Othman and Ameer, 2014); and the latest, an arrest of Islamic NPO's top management for embezzlement (Hassan, 2017). All these accountability issues happened because of the weaknesses in internal control practices of these NPOs.

Based on these cases, internal control practices are believed to be one of the key factors that impact on accountability in NPOs (Jabnoun, 2012). This is because most of these organizations are depending on public donations as the core element to survive and render their services to the public. By having good internal control practices, they can avoid deficiencies that can diminish public support especially by donors (Petrovits et al., 2011). Besides, good internal control practices also will lead to efficient and effective use of the donated funds (Siraj and Karbhari, 2014) and this will give an assurance to the public on their donations usage and make NPOs more sustainable and trusted (Sulaiman et al., 2008). In addition, previous study on internal control components such as control environment, control activities and monitoring activities identify that internal control practices significantly influence financial accountability (Widyaningsih, 2015). Previous studies by Abraham (2003) and Sloan (2009) summarized that good internal control practices contribute to the positive accountability rating and indirectly increase the donation received by NPOs.

Apart from understanding internal control practices, we need to understand the accountability aspect, in order to achieve the objective of this study which is to examine the impacts of internal control practices on financial accountability in Islamic NPOs. In general, accountability in NPO can be viewed from three aspects, which are: (i) accountability 'to whom'; (ii) accountability 'for what'; and (iii) accountability 'on how' (Ebrahim, 2003). Accountability 'to whom' focuses on recognizing parties involved with an organization. This includes the four accountability 'to whom' groups, which are: (i) upward accountability – donors and government; (ii) downward accountability – beneficiaries, clients and partners; (iii) inward accountability – members, volunteers and staff; and (iv) horizontal accountability – media, constituents and general public (Agyemang et al, 2009; Ebrahim, 2010; O'Dwyer and Unerman, 2007).

Meanwhile, accountability 'for what' focuses on identifying for what kind of accountability an organization is accountable. In order to recognize accountability 'for what', previous studies normally will recognize the accountability dimension. Many accountability dimension types have been debated (Behn, 2001; Brinkerhoff, 2004; Ebrahim, 2010; Jordan and Van Tuijl, 2006). However, in general, accountability can be simplified into two dimensions: (i) accountability for internal stakeholders; and (ii) accountability for external stakeholders (Kamaruddin and Ramli, 2015; Raffer, 2004).

Accountability 'on how' refers to the way an organization should act in delivering its accountability. By drawing on academic literature, we identified several accountability mechanisms such as disclosure statements and reports, performance assessment and evaluation, participation, self-regulation and social auditing (Agyemang et al., 2009; Ebrahim, 2003, 2010). These accountability mechanisms can be divided into two major groups, namely accountability tools and accountability processes (Ebrahim, 2003).

In general, most prior studies highlight the significant impacts of internal control practices on accountability in NPOs under the general point of views. However, there is limited study conducted on examining specific impacts of internal control practices especially on financial accountability. Specific impacts of internal control practices based on all three accountability aspects, which are: (i) accountability 'to whom'; (ii) accountability 'for what'; and (iii)

accountability ‘on how’ are yet to be studied. Therefore, this gap in the literature motivated us to conduct this study. Besides, several recent abuse and misconduct of public fund cases in Malaysia mostly happened in Islamic NPOs. Therefore, this study is motivated to focus on Islamic NPOs in Malaysia.

3. METHODOLOGY

3.1 OBJECTIVE AND SAMPLES

This study aims at identifying the impacts of internal control practices on financial accountability in Islamic NPOs. This study is an extension of a study by Kamaruddin and Ramli (2017) on examining current internal control practices for NPOs in Malaysia. Therefore, this study identifies the following extension of research questions from the previous study. The research question is: what are the impacts of internal control practices on financial accountability in Islamic NPOs in Malaysia?

For sample selection, the selected sample must be reliable and can be represented as Islamic NPOs in Malaysia. Many types of NPOs exist in Malaysia; therefore, Islamic NPOs with humanitarian relief objectives were chosen as a sample for this study. This selection had been made as recent public fund misconduct cases in Malaysia involved this type of NPO. Additional criteria used to choose selected sample for this study is all selected NPOs are under the same registered or legal form. Therefore, a company limited by guarantee (CLBG) with humanitarian relief objectives is defined for selection because to register as CLBG, the revenue (funds collected) must be more than RM1 million as compared to other types of NPOs where their requirements are lesser as compared to CLBG. Finally, all selected NPOs must have Islamic values such as getting involved with the Islamic charity funds (such as *sadaqah*, *waqf*, and *zakāt*) and are also being run by Muslims in Malaysia.

Based on previous study (Kamaruddin and Ramli, 2017), the extension of this study also selected the same three previous Islamic NPOs namely Institution A, Institution B and Institution C as samples. To ensure that findings are unbiased, these three selected Islamic NPOs ought to have similar characteristics as mentioned earlier, which are:

- a. Established in Malaysia and run by Muslim;
- b. Registered as company limited by guarantee (CLBG) under the Companies Commission of Malaysia (CCM);

- c. Bound by the Companies Act 1965;
- d. Share the same organizational objective which is to support humanitarian relief and provide aid for Muslims around the world; and
- e. Involve with Islamic charity funds such as *ṣadaqah*, *waqf*, and *zakāt*.

The details for each selected Islamic NPOs are as follows:

3.1.1 INSTITUTION A

Institution A was incorporated on June 25, 2004, and officially launched on May 3, 2005, by the Prime Minister of Malaysia, Tun Dr. Mahathir Mohamad. Institution A is one of the 45 branches of its parent known as Institution Z. Institution Z which was established earlier in 1984 is based in the United Kingdom. Institution Z has expanded its operation in the Asia-Pacific region with the establishment of Institution A. Institution A is registered as a CLBG type of company under the CCM.

The purpose of Institution A is to continue humanitarian aid by Institution Z in the Asia Pacific region. Operating as fundraising office (local and international projects) and field office (implementing local projects), Institution A contributes in implementing community, economic and social development programs in Malaysia. As a fundraising office, it receives most of the funds in the form of an Islamic charity fund which is *ṣadaqah*. It also accepts other types of funds such as *waqf* and *zakāt*. Institution A also generates its own income from trading activities carried out by its social enterprise under the Charity Shoppe and Event Division.

Institution A is led by a Country Director who is responsible to the Board of Director (BOD). The BOD comprises six members, a combination between Malaysians and representatives from Institution Z. The BOD's responsibility is to govern all programs and activities of Institution A. This board is also being held responsible for the budget regarding the distribution of *ṣadaqah* funds based on programs and activities planned by the management of Institution A. Institution A has four divisions consisting of the Relief and Programs Division, Services Division, Fundraising Division and Charity Shoppe and Event Division. The one responsible for the financial process is the Services Division where there are five departments

under this division namely Finance, Procurement, Account, Human Resource, and also Administration Departments.

3.1.2 INSTITUTION B

Institution B was incorporated on February 4, 2010. Previously, Institution B was known by another name. However, since July 16, 2014, its name has been changed until now. The name change was to align with its new extended scope. Institution B used to focus on Palestinian issues, and now the focus has been extended to other Muslim issues around the world. Six agencies come under Institution B where each agency is focusing on its specific mission and targets. Institution B is registered as the CLBG type of company under the CCM.

The purpose of Institution B is to furnish financial support and human expertise, and channel them with diligence and provide appropriate solutions to the beneficiaries. Institution B also acts as an intermediary to disseminate accurate information regarding humanitarian issues and also collaborates professionally with other local and international organizations in achieving its missions to its beneficiaries. Most of the funds received by Institution B are recognized as Islamic charity fund which is *sadaqah*. Other types of funds such as *waqf* and *zakāt* are also collected. Institution B also generates its own income from branding activities, for instances when the institution's logo is being used by other commercial products, Institution B is entitled to royalties.

Institution B is led by a Chief Executive Officer (CEO) who is responsible to the BOD. The BOD consists of 16 members, each one of them are being responsible for governing one out of six agencies under Institution B. The BOD also is responsible for the budget regarding the distributing of Islamic charity funds based on programs and activities planned by the all six agencies. Each agency has a specific target where the Agency A is for Palestine, Agency B for Syria, Agency C for women empowerment, Agency D as a Research Centre for the Muslim world, Agency E for South East Asia and Agency F for Iraq. Institution B and its six agencies are supported by four departments consisting of Accounting, Human Resource, Research and Development, and Public Relation Departments. The one responsible for the financial process is the Accounting Department.

3.1.3 INSTITUTION C

Incorporated on January 3, 2006, Institution C was registered as the CLBG type of company under the CCM. The mission of Institution C is to help and distribute *ṣadaqah* contributions while observing the welfare and human rights of the Palestinians as a whole. Most of the funds received by Institution C are recognized as Islamic charity fund which is *ṣadaqah*, although other types of funds such as *waqf* and *zakāt* are also accepted. Institution C also generates its own income from trading activities when it commercializes its products and gains revenues to support its projects and activities.

Institution C is led by a CEO who is responsible to the BOD. The BOD consists of six members responsible for governing all the institutional programs and activities. The BOD also is responsible for the budget relating to distribution of Islamic charity funds based on programs and activities planned by the Institution C management. Institution C has eight departments consisting of the Administration, Finance, Marketing, Public Relation, Human Resource, *Kafalah*, Charity Shop, and Research and Development Departments. The one responsible for the financial process is the Finance Department.

3.2 DESIGN

This study employs case study method to analyze the impacts of internal control practices on financial accountability in Islamic NPOs in Malaysia. Previous studies suggested case study as the best method for analyzing specific system practices such as internal control practices in an organization as a focus for this study (Yin, 2014). Specifically, this study employs a single case study. A single case study is analogous to a single experiment and has many of the same conditions that justify a single experimental result (Yin, 2014). Besides, this study employs an explanatory case study type as suggested by Baxter and Jack (2008), where explanatory case study is best to be used in order to find an answer regarding current practices of an organization.

For data collection, this study employs a shorter case study interview. The interview questionnaires are directly based on the objectives of the study as mentioned earlier in this section. Shorter case study interview takes approximately one hour. These interviews are conducted in open-ended style but are still in compliance with case study protocol (Yin, 2014). For interviewee selection,

interviewees from the specified Islamic NPOs were selected through purposive sampling (Patton, 1990). This requires selected interviewees to be knowledgeable of the financial systems for Islamic NPOs in Malaysia. This is important to ensure that the interviewees can demonstrate how internal control is being adopted and how it influences financial accountability in their organizations. Interviewees are the persons in charge of finances in selected Islamic NPOs such as chief financial officer, financial officers and others related to collecting, managing and distributing *sadaqah* funds (Bowrin, 2004). Thus, two interviewees, which are head of financial department and chief executive officer (CEO) from each selected Islamic NPOs in Malaysia are selected. These two interviewees are selected based on their in-depth knowledge regarding current practices of the internal control in their Islamic NPOs. These two interviewees are involved and responsible for current practices of the internal control and its impacts on financial accountability.

For reporting, this study employs an option for multiple-case study. This approach combines information on the three selected Islamic NPOs into a single written report (Yin, 2014). This approach provides in-depth understanding especially on the impacts of internal control practices on financial accountability in Islamic NPOs in Malaysia in the collective form. This method is usually preferred when the information needs to be explained in detail.

Due to the concept of anonymity and confidentiality as suggested (Wiles et al., 2008), the real names of these three Islamic NPOs will not be disclosed. The information obtained is from a primary source (from the interviews) therefore it is unethical to reveal the identity of the organizations. To ensure that every statement was documented, the interviews were recorded. They were conducted from the beginning of January until the end of March 2016 at the three selected Islamic NPOs in Malaysia.

4. FINDINGS AND DISCUSSIONS

This section has been divided into three parts. First, financial accountability in Islamic NPOs in Malaysia focuses on financial accountability 'for what' whereby internal control is seen as part of the financial accountability process. Second, financial accountability focuses 'on how' in which the results from internal control practices must be discharged through financial disclosure as a financial accountability tool. Finally, financial accountability focuses on financial accountability 'to whom' which identify internal control

practices supporting Islamic NPOs to gain both power (*khilāfah*) and trust (*amānah*) from stakeholders.

4.1 THE IMPACT ON FINANCIAL ACCOUNTABILITY ‘FOR WHAT’

In general, all three selected Islamic NPOs agreed that internal control practices have impacts on financial accountability. In terms of financial accountability ‘for what’, findings identify financial accountability based on internal control practices in these three Islamic NPOs in Malaysia. For instance, Institution A has their own ‘Quality and Accountability Framework’ set up by their parent BOD, Institution Z. The framework highlights three main principles that need to be carried by the BOD roles, which are:

- a. Ensuring quality of projects, programs, and activities through standardized projects cycle management;
- b. Demonstrating accountability for aid receivers; and
- c. Assuring quality and accountability.

This framework is recognized by the Core Humanitarian Standard (CHS). In this framework, to ensure the quality of projects, programs and activities in Institution A, one of the BOD roles is to ensure that all current internal control practices are in accordance to procedures and policies set up by them.

Meanwhile, the BOD for Institution B is responsible for monitoring and reviewing all financial progress for every month. This is to ensure current internal control practices operate as per required by the institution’s policy and guidelines. This is based on the following conversation pertaining to the BOD’s responsibilities on financial accountability for Institution B:

...Our BOD will have monthly meeting. In that meeting, we need to present monthly progress including monthly financial statements for the BOD acknowledgment. The BOD will make sure that current progress is in accordance to as planned before. In addition, we also have director-in-charge that monitors closely Accounting Department to ensure we are in compliance to policies and guidelines. This director-in-charge also acts as an advisor for financial matters...

Similar to Institution B, the BOD for Institution C is responsible for monitoring and reviewing all of the financial progress for every month. This is also to ensure that current internal control practices operate as per required by the institution's policy and guidelines. This is based on the following conversation regarding the BOD responsibility for financial accountability for Institution C:

...Our BOD will have monthly meeting where we need to present monthly progress including monthly financial statements for the BOD's acknowledgment. The BOD will make sure that current progress is in accordance to as planned before. In a financial aspect, the BOD will also ensure that our financial operations are in compliance with guidelines and procedures set up by the BOD...

In terms of management responsibility for internal control practices, all of the three selected Islamic NPOs also agreed that management plays an important role in ensuring that current internal control practices are in compliance with the institutions' standard operating procedures and policies. For instance, the BOD meetings for Institution A are only held twice a year; therefore, most of the decisions are being made at management level during day-to-day operation. This includes management responsibility for daily operations including financial operations. They need to ensure that all procedures, policies, and guidelines being set up by the BOD are complied. This is because, at the end of every year, the BOD will evaluate the management based on their operation and performance. This is based on the following conversation regarding management responsibility for financial accountability for Institution A:

...Every year, management will be evaluated by our BOD and also our parent, Institution Z. Evaluation will be made based on our operation quality and performance. Several targets set up by the BOD knew as Key Performance Index (KPI) needs to be achieved to ensure that we have delivered our services at the best practices. For financial aspect, there is also risk evaluation to evaluate our organization's risk level whether it is a low, medium or high risk. By having good internal control practices, it will reduce financial risk result...

The above conversation shows that management is responsible in ensuring that all procedures and policies set up by the BOD are being complied. They also have the KPI evaluated by the BOD and Institution Z to ensure that they are adhering with organizational objectives and values. They also have risk evaluation on financial aspect and it has been said that internal control practices will affect this risk evaluation.

For Institution C, the management also plays an important role to ensure financial operations including internal control practices are in good operation. For this purpose, the Human Resource and the Finance Departments of Institution C are assigned to supervise internal control practices by all of their 18 branches including Gaza branch. This is based on the following conversation regarding the management responsibility for financial accountability for Institution C:

...Every year, we assigned some staff from Human Resource Department and Finance Department to do internal audit process for all 18 branches including Gaza branch. This task will be conducted focusing on their performance regarding financial operations including internal control practices. This is to ensure that all our branches are in compliance with institution's procedures and policies...

From the above conversation, it can be said that management of Institution C also plays an important role in ensuring internal control practices are in accordance with organization's procedures and policies.

4.2 THE IMPACT ON FINANCIAL ACCOUNTABILITY 'ON HOW'

In terms of financial accountability 'on how', findings identify financial accountability based on internal control practices in these three Islamic NPOs in Malaysia with the financial disclosure as an accountability tool in discharging financial accountability. The findings are discussed in terms of three different experiences on financial accountability issues and solved by internal control practices on their organizations. For Institution A, its latest experience regarding the relation between internal control and

financial accountability through financial disclosure is summarized in the following situation:

SITUATION 1: INDEPENDENT CHECK BY INSTITUTION A

As we know, Islamic State (IS) crisis has currently occurred especially in the Middle East regions. Most of the world citizens are aware of this issue. Their terrorism activities give negative impact to Muslim for general [sic] and Islam as a peaceful religion. This IS crisis [is] also affecting Islamic organizations including Institution Z, our parent organization based in the UK. UK citizens questioned that ṣadaqah receives [received] by Institution Z and its branches including Institution A are used for funding IS terrorism activities. This perspective gives negative impression on financial accountability for our institution and affects our operations in collecting, managing and distributing ṣadaqah funds. To overcome this matter, our organization had been audited by external auditors. The result shows that our organization is not linked and for sure not supporting IS terrorism activities in terms of funds distribution and other activities. Independent checks by external auditors and audit report acts as evidences that our organization is operating in good practices. This is because our internal control practices is able to give a reliable evidence and financial information including consolidation [consolidated] financial statement where Institution A is one of the Institution Z branches for the external auditor to give a true and fair opinion regarding financial operations. Besides answering citizens' inquiry, auditor report also gains confidence for the public to support our organization, especially for funds collection.

From the above case, Institution A relies on internal control practices to overcome financial accountability issues raised by the public. By gathering reliable evidence (audited financial statements) from internal control practices, it supports Institution Z and its branches including Institution A to overcome this financial accountability issue.

For Institution B, its latest experience regarding the relation between internal control and financial accountability through financial disclosure is summarized in the following situation:

SITUATION 2: PERFORMANCE MANAGEMENT BY INSTITUTION B

Currently, we are focusing on reducing our administration cost. It actually started after public inquiry on our managing şadaqah funds process. As they concern [sic] on distribution process, they hope that Institution B can maximize şadaqah funds received to maximize its activities and channeled [sic] to beneficiaries. To overcome this matter, Institution B plan to raise its own income rather than receiving şadaqah funds process to cover its administration cost. At first, we decided to sell our own products to gain income. However, there is an issue about risks in selling products. Thus, we decide to sell our organization's brand. Few business organizations agreed to use our brand and we get royalties for every selling product that used our brand. This royalty's income will be used to support our administration cost and şadaqah funds collection can maximize its useful [usefulness] for activities and programs. This practice had been commenced in 2012. Based on our annual report, we managed to reduce our administration cost from 9% from total expenditures in 2010 to 5% in 2013 and 3% in 2014 by using royalty's income. We are aimed to achieve 0% administration cost in the future. This positive decline in administration cost tends to attract more şadaqah funds contributed by the public. By having internal control practices such as proper documentation and records, we managed to give reliable evidence and information toward public regarding this reducing administration cost strategy. Based on our annual report, our organization's revenue based on şadaqah funds collection had increased for every year as our administration cost decline for every year. This also shows that public is a concern on how we maximize our şadaqah funds raise [raised] to our activities and programs.

From the case mentioned above, Institution B relies on internal control practices especially on proper documentation and records to overcome financial accountability issues raised by the public. By supporting its financial accountability with reliable

evidence and information from internal control practices, Institution B is able to overcome this financial accountability issue.

For Institution C, its latest experience regarding the relation between internal control and financial accountability through financial disclosure is summarized in the following situation:

SITUATION 3: FINANCIAL DISCLOSURE BY INSTITUTION C

In the middle of the year 2015, our money has been distributed to support few projects and activities in Palestine which had been suspended by Israel government. This occurred because Israel government gets the information that our institution is funding and supporting Palestine fighters against Israel. This suspended money issue also had been coverage [covered] by national news and raise public inquiry regarding their donations. To overcome this issue, three main actions had been taken by Institution C. First of all, we call media practitioners to cover our press conference. Press conference has been made to explain in detail regarding the issues and to deny Israel government's accusation. We also stressed that Institution C aid Palestine in humanitarian relief programs and activities. By using audited financial statements as evidence, we also prove that Institution C never supports such any Palestine fighters against Israel. Secondly, we ask few NGOs based at West Bank to push Israel Government for this issue. As we have good track records especially in our programs and activities, we convince them to support Institution C regarding this issue. Third, we also have been supported by the Ministry of Home Affairs and the Ministry of Foreign Affairs regarding this issue. The Ministry of Home Affairs releases a statement as to show that Institution C is not related [to] and [not] support any Palestine fighters while the Ministry of Foreign Affairs addresses this statement to Israel government. Finally, Israel government release [retracted] the accusation made to our institution and we can continue our programs and activities for Palestine.

From the case, Institution C relies on internal control practices to overcome financial accountability issues raised by the public. By furnishing reliable evidence (audited financial statements) from

internal control practices, it supports Institution C to overcome this financial accountability issue. Based on these aforementioned three cases regarding the relation between internal control and financial accountability, there is significant evidence that financial disclosure becomes an important mechanism in discharging financial accountability. There is also significant evidence that good internal control practice such as documentation and records will contribute to reliable financial disclosure information and it indirectly affects financial accountability.

4.3 THE IMPACT ON FINANCIAL ACCOUNTABILITY ‘TO WHOM’

In terms of financial accountability ‘to whom’, findings identify financial accountability based on internal control practices in these three Islamic NPOs in Malaysia with its stakeholders especially on power (*khilāfah*) and trust (*amānah*). This financial accountability to ‘whom’ is achieved when internal control practices support Islamic NPOs in financial accountability process and financial accountability tool to gain both power (*khilāfah*) and trust (*amānah*) from stakeholders. Institution C stated that by having audited financial statements, it gained more benefits and confidence from stakeholders. This is based on the following conversation regarding the relation between internal control and financial accountability through financial disclosure with Institution C:

...By having audited financial statements, we used it to gain some benefits such as by getting tax deduction authority for every donation made by donors from the Inland Revenue Board of Malaysia (IRBM). We also used our audited financial statements to get permission from the State Islamic Religious Council (SIRC) for zakāt collection authority purpose. Besides that, we also used our audited financial statements to raise corporate donors such as Telekom Malaysia (TM) and Pos Malaysia Berhad. All of this happens as they are believed [sic] with our management in projects, programs and activities conducted...

The above conversation shows both kind of powers (*khilāfah*) receives, which are authorized for collecting *zakāt* from the SIRC and tax deduction authorized by the IRBM. Meanwhile,

trust (*amānah*) was also achieved when Institution C gained donation support from corporate donors as they trusted the operation of Institution C. Moreover, every project, program, and activity conducted by these three selected Islamic NPOs in Malaysia, usually utilize mass media, especially social media, to inform the public about their current programs and activities.

For Institution A and Institution C, they have donor supporters who give access to promote their activities such as sponsoring mass media advertising while Institution B has good connections with mass media to do so. This is to ensure all related stakeholders especially public are not only aware pertaining to the humanitarian relief programs and activities but also to enhance their accountability as trusted institutions that conduct these humanitarian relief programs and activities.

Besides that, they also inform the public by using their own website. Institution A, for example, publishes its annual reports on its website to increase public confidence, especially for financial accountability. In addition, all these three selected Islamic NPOs in Malaysia also publish their programs, activities, projects and achievements to increase public trust in their operations. By increasing transparency on their projects, programs and activities they will gain a higher accountability perception level from the public. This is based on the following conversation regarding financial disclosure discharging financial accountability with Institution A:

...We believe by being more transparent in our projects, programs, and activities, we are more accountable toward stakeholders especially donors and beneficiaries. Normally donors are concerns [sic] on how their money being spent. By having such annual reports with interesting figures (not to details in financial figures but more on impact figures), people will be more attracted to continuously donate with us...

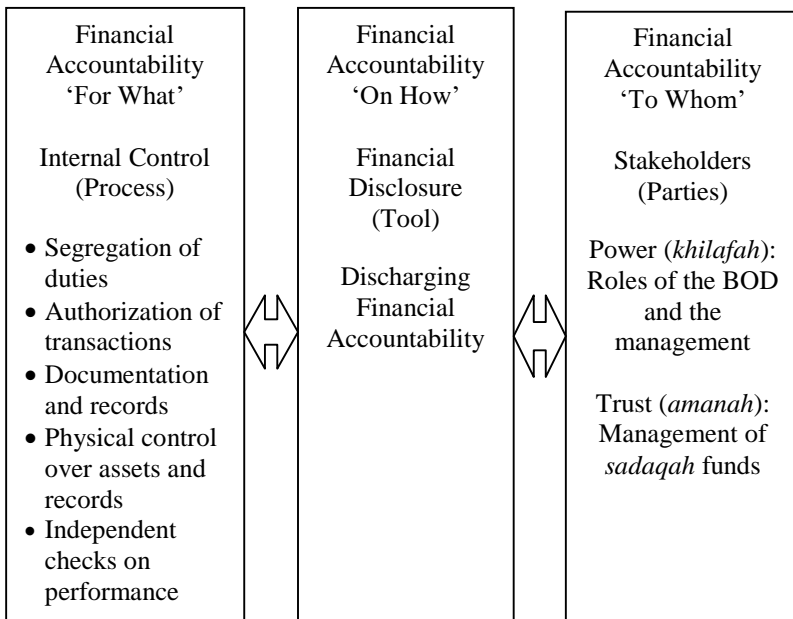
The above conversation shows that more transparency in progress reports regarding organization's projects, programs and activities will give higher confidence, especially to donors. The above conversation also proves that public especially donors are concerned how their *sadaqah* funds are managed by these organizations. This also affects the organizational sustainability as

people will continuously donate if they are confident with the organization's operation and performance.

Based on the three different financial accountability cases and also several other policies to inform their programs, activities, projects and achievements toward the public, it can be said that reliable financial disclosure is essential, especially to answer public queries regarding the financial accountability aspect. Thus, this finding supports a previous finding by Irvine (2005) that reliable accounting information is needed to analyze existence of financial issues so that action can be taken to overcome them. This finding also strengthens the relationship between reliable financial disclosure by internal control claimed by Spitzer (2005) and Shiri et al. (2012) that good internal control practices will ensure adequate policies and procedures and also guarantee assets and records protection thus ensuring reliable financial disclosure.

FIGURE 1

The Impacts of Internal Control Practices on Financial Accountability in Islamic NPOs in Malaysia



The impacts of internal control practices on financial accountability can be viewed from reliability, decision and legitimacy theories as discussed earlier. The impacts are also interrelated and benefit both the BOD and the management of the Islamic NPOs as they gain both power (*khilafah*) and trust (*amanah*) from stakeholders based on agency theory. Thus, a summarization of impacts of internal control practices on financial accountability in Islamic NPOs in Malaysia is shown in Figure 1.

5. CONCLUSION

Good internal control practices are one of the mechanisms to ensure proper management of Islamic NPOs. This study presents the impacts of internal control practices on financial accountability for all three selected Islamic NPOs in Malaysia.

Based on the findings, it can be said that internal control practices are important for Islamic NPOs as they significantly impact financial accountability. A positive relationship exists between internal control and financial accountability in Islamic NPOs. Financial disclosure is also highlighted as an intermediary that connects internal control and financial accountability. This also stresses the power (*khilafah*) and trust (*amanah*) in financial accountability. Moreover, this study also identified that internal control and financial disclosure are interrelated and supporting each other toward financial accountability. This finding supports previous studies that financial disclosure is recognized as a mechanism in discharging financial accountability (Connolly and Hyndman, 2004; Zainon et al, 2013). By implementing adequate internal control practices, Islamic NPOs create good impact and solve their financial accountability issues.

This study has laid the groundwork for several strands of future research. Since this study was based on only three Islamic NPOs with humanitarian relief objectives in Malaysia, its findings are unfit for making a generalization on the same good practices of internal control in other Islamic NPOs. Moreover, this study has just focused on the CLBG type of Islamic NPOs. Other types of Islamic NPOs also have potential to be studied in terms of the internal control aspects. This study of internal control can also be applied to a broader scope by looking at other religious types of NPOs as well as general NPOs.

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