



**ACCOUNTABILITY THROUGH REPORTING: THE
STUDY OF “FOUNDATIONS” IN MALAYSIA**

BY

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degree of Master of Science in Accounting**

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ABSTRACT

The increasing number of foundations provide many advantages to national social, economic and political development. However, misappropriation of funds and falsifying the reporting information have deteriorated public trust in foundations. This research seeks to identify the accountability mechanisms of foundations in Malaysia and addresses reporting practices and its relation to accountability from legal, bureaucratic, and social perspectives. Four different legal foundations participated in this study including state-owned (Foundation A), State Religious Council-owned (Foundation B), private-independent (Foundation C) and private-corporation (Foundation D). Semi-structured interviews with account and administrative manager and document review were developed to collect data. This study uses an 'accountability-reporting' framework as a skeletal guide adapted from Ebrahim (2003b) and Unerman (2007). The findings indicated there are three primary groups of stakeholders to which foundations in Malaysia are accountable, namely funders, legal authorities and communities. It can be asserted that the reporting practices of foundations are varied according to their legal forms. The study found that each foundation prepared its reports to suit the stakeholders to which they are most accountable. The results also showed that foundations exercise accountability through formal reporting along with voluntary reporting to engage with the stakeholders.

ملخص البحث

إنّ ازدياد عدد المؤسسات يوفر مزايا عديدة للتنمية القومية اجتماعيًا، واقتصاديًا، وسياسيًا، لكن انعدام التمويل اللازم، والتقارير المعلوماتية المزيّفة أدّى إلى تدهور ثقة الجمهور في هذه المؤسسات المحاسبية. وإنّ هذا البحث يرمي إلى تحديد الآليات التي تتبعها المؤسسات في ماليزيا للمحاسبة، ويتعرّض البحث أيضًا لممارسة إعداد التقارير وعلاقتها بالمحاسبة في ضوء وجهات النظر القانونية، والبيروقراطية، والاجتماعية. لقد تناولت هذه الدراسة أربع مؤسسات قانونية مختلفة شملت: أ) المؤسسات المملوكة للدولة. ب) المؤسسات التي يملكها مجلس الشؤون الدينية بالولاية. ج) المؤسسات الخاصة المستقلة. د) المؤسسات الخاصة. لقد اعتمد في جمع المعلومات لهذه الدراسة على إجراء مقابلات شبه مقيدة مع محاسب، ومع مدير إداري، إضافة إلى ذلك تمّ استعراض بعض المستندات والاطّلاع عليها. واستخدمت هذه الدراسة إطار التقرير المحاسبي لإبراهيم (2003م)، وأونرمان (2007م)، بعد أن تمّ تعديلها ليكونا دليلًا هيكليًا. وأظهرت النتائج أنّ المؤسسات المحاسبية القانونية في ماليزيا مسؤولة لدى ثلاث فئات من أصحاب المنفعة هي: الممولون، والسلطات القانونية والمجتمعات. ويمكن تأكيد أنّ ممارسة إعداد تقارير المؤسسات تتنوع بتنوع أشكالها القانونية. ولقد توصلت الدراسة إلى أنّ أيّ مؤسسة محاسبية تعدّ تقاريرها لتناسب أصحاب المنفعة الذين تكون مسؤوليتها كبيرة أمامهم. وأظهرت الدراسة أيضًا أنّ المؤسسات تمارس المحاسبة عن طريق التقارير الرسمية والطوعية معًا في مخاطبة أصحاب المنفعة.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion; it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science in Accounting.

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DECLARATION

I hereby declare that this dissertation is the result of my own investigation, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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This dissertation is dedicated to my beloved parents and Muslim ummah.

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LIST OF ABBREVIATIONS

AR	Annual Report
BOT	Board of Trustees
CCM	Companies Commission of Malaysia
CLBG	Company Limited by Guarantee
CSR	Corporate Social Responsibility
FA	Foundation A
FB	Foundation B
FC	Foundation C
FD	Foundation D
MASB	Malaysian Accounting Standard Board
MRT	'Middle-Range' Thinking
MT	Management Team
NPOs	Non-profit Organisations
SER	Social and Environment Reporting
SFAS	Statement of Financial Accounting Standard
SOP	Standard of Procedures
SORP	Statement of Recommended Practice
SRC	State Religious Council
UK	United Kingdom
USA	United States of America

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

The increasing number of Non-profit Organisations (NPOs) has contributed to social, economic and political developments. NPOs also known as the third-sector force have grown rapidly. They have different aim varying from simple one-off to a strong permanent entity delivery.

The main difference distinguishing between NPOs and private entities is its lack of a profit motive. It differs from the public organisations as it lacks a bureaucratic nature (Osman, 2010). Their aim is to serve social good. To generate activities and accomplish their objectives, most NPOs rely on the generosity of the public to fund their services. Various forms of NPOs have been established including foundations, charitable organisations, religious organisations, and societies (Othman & Ali, 2012).

The increase in fraudulent and money laundering activities in the NPOs attracted the serious attention of researchers to the study of NPOs (Connolly & Hyndman, 2013a; Gibelman & Gelman, 2004). In Malaysia, there have been numerous reports of substantial funds from foundation owned by the Malaysian Prime Minister's Department used for personal purposes (Wright, 2015).

Though set up to help underprivileged Malaysians through education and sport; this charity soon got involved in spending that appeared designed to help candidate retain power in May 2013 election (The Wall Street Journal, June 2015).

This shows the inappropriate action by the public foundation which is expected to use the funds to serve the public interest. Regulators also claimed that foundation failed to submit required financial statements since its inception in early 2013.

In 1981, a seminal study by Birds and Morgan-Jones cast significant doubt on the usefulness of charities' annual reports and accounts as a means of providing accurate, reliable, and comparable information to stakeholders (Connolly, Hyndman, & McConville, 2011). This is because the majority of the charities counted the contribution received as capital or separated it into capital and revenue to understate the amount of revenue from donors. It highlights the issue of integrity due to falsifying the information. Thus, it is becoming essential for NPOs to show accountability and transparency in dealing with public funds. Since the public trusts them, they need to avoid mismanagement and report transparently.

Poor accounting and reporting and, as a consequence, the possibility of scandals could severely undermine confidence in the NPOs. The adoption of appropriate accounting and reporting practices has the potential to provide a basis for greater faith in the control processes within charities and result in a more accountable and legitimate sector. As a result, public confidence will be enhanced. This is necessary for the sustainability of the non-profit sector.

NPOs can apply accountability through various mechanisms such as reports and disclosure statements, performance assessments and evaluations, participation, self-regulation, and social audits (Ebrahim, 2003a). The majority of the NPOs will use reporting as mechanisms of accountability (Ebrahim, 2003a; Samkin & Schneider, 2010). Developed countries have their standards and regulation to govern NPOs, especially charitable organisations to prepare the annual report and financial reporting. Private authorities and government in developed countries such as the US, UK,

Australia and Canada have introduced numerous initiatives to set up guidelines and recommended practices for charities (Connolly et al., 2011; Othman & Ali, 2012). This includes the Statement of Recommended Practice for Charities (SORP), Statement of Financial Accounting Concept (SFAS) 116 and 117, accounting recommendations by NPOs and disclosure practices in non-profit entities. These guidelines provide an idea on how to account the financial information and are a basis for reporting in NPOs.

However, NPOs in developing countries face more challenges by having no specific governing reporting framework, minimum regulations and little concern from the government regarding accountability and transparency (Othman & Ali, 2012). This exposes NPOs to the possibilities of fraudulent reporting and misappropriation of funds. Besides, the public does not always demand accountability from the NPOs. This weakens the accountability discharged in the organisation. Despite the existence of formal accountability through reporting, smaller NPOs are more likely to have informal mechanisms of accountability as their stakeholders are involved in the day-to-day activities with the management (Connolly & Hyndman, 2004). This shows the various mechanisms of accountability that can be applied in NPOs to fulfil the needs of the stakeholders.

This study chooses foundations¹ as one type of NPOs for several reasons. Firstly, foundations exercise greater ‘formality’ since they are governed by a legal framework and specific regulations compared to other types of NPOs. They are monitored by various authorities and their governance consists of a board of trustees while still operating as a non-profit entity. Palmer (2013) states the NPOs currently

¹ The word foundation and NPOs used interchangeably in this paper. Since the area of accountability and reporting of foundation is new in this non-profit sector, most of the literatures cited is based on the NPO context.

face multiple and differing requirements and a variety of legislations applied, and this has presented challenges to accountability. This may create similar challenges to the reporting of foundations since they are established under different legislation. These characteristics make the reporting practices and the relation with accountability discharged by foundations an interesting context to study. Secondly, most of the studies of NPOs focus on charitable and religious organisations, thus more research needs to be done on foundations especially in developing countries.

1.2 RESEARCH OBJECTIVES AND RESEARCH QUESTIONS

The aim of the study is to explore the accountability practice in the foundation. Since there are various mechanisms of accountability, the study focuses on reporting as the medium of accountability. To achieve the aim of the research, the foundations will be examined based on the following research objectives (ROs):

1. To identify the primary stakeholder of the foundation and its respective accountability mechanism.
2. To examine the reporting practices of the foundation.
3. To understand the reasons for reporting and its relation to accountability discharged to stakeholders.

To achieve the research objectives, five research questions (RQs) are developed:

1. Who are the stakeholders to whom the foundation is most accountable?
2. What information is currently reported in the foundation?
3. Why should the foundation provide reporting?
4. How does accountability influence the reasons for reporting in the foundation?

RQ1 refer to the priority of stakeholders that foundations need to accountable. As the foundation required to answer to many stakeholders (Connolly & Hyndman, 2013b; Jordan, 2005; Schatteman, 2013), this study seeks to identify the main stakeholders which they accountable most and the forms of accountability related to the stakeholder.

Reporting information in RQ2 refers to types of reporting prepared in every organisation i.e. legal reporting, management reporting and social reporting (Granof, 2007; Monfardini, Barretta, & Ruggiero, 2013; Steccolini, 2004). This information is normally provided to satisfy the reporting demands of various stakeholders. RQ3 and RQ4 are developed to understand why foundations provide the reporting and how does accountability influence to certain stakeholders influence the choices of reporting made.

The next discussion will elaborate further on the motivation of this study.

1.3 MOTIVATION OF THE STUDY

The growing number and size of foundations provide a lot of advantages and benefits to the society (Costa, Parker, & Andreaus, 2014). However, several issues involving misappropriation of fund and falsifying the reporting information have deteriorated the trust of the public in foundations. Statistics of fraud activities taken from the Association of Fraud Examiners 2012 Global Fraud Survey (which includes for-profits) showed asset misappropriation schemes made up 87% of reported cases and median losses for non-profits totalled \$100,000 (The NonProfit Times, 2013).

Foundations, the article reported, had defrauded an unsuspecting international public of hundreds of millions of dollars for personal gain (WND, 2015). There are also an increasing number of cases of misuse of funds in Malaysian foundations. The

most recent are in November 2015, when National Oversight and Whistleblower Centres (NOW) revealed misappropriation of funds in one of the foundations owned by agencies in the Prime Minister's Department (Ng, 2015). The public fund should benefit all and not to be used for personal interests. Also, the embezzlement of funds in 2014² underscored the importance of transparency of reporting (Sinar Harian, 2014). The closure of a university operating under a private foundation raised the issue of whether the foundation needs to be accountable to its mission and vision or merely followed the demand from the funders (Sue-Chern, 2014).

These reported cases show there is an accountability issue in foundations i.e. whether they are working towards public interest or personal gains. The public has high expectations of these institutions since they are trying to help the nation. However, the existence of fraud cases may erode the public trust in the foundation sector.

This problem may be due to a lack of guidelines as to whom the foundation should be accountable. A range of different stakeholders who can be served by accounting and reporting, including beneficiaries, government, regulators and the public (Connolly & Hyndman, 2013a). Hyndman & McDonnell (2009) state that potential problems with multiple accountabilities (as multiple stakeholders exist) lead to either an over-provision of information (which may be costly) or an under-provision of information if each user assumes that another is monitoring the entity. However, as is the case in developing countries, NPOs are generally reluctant to share comprehensive information with the various stakeholders and may not recognise the need for accountability (Arshad, Bakar, Thani, & Omar, 2013). This leads

² The information was retrieved in the article entitled 'Seleweng dana: Datuk, pengarah yayasan ditahan' on 27th January 2014 in Sinar Harian online at <http://www.sinarharian.com.my/mobile/semasa/seleweng-dana-datuk-pengarah-yayasan-ditahan-1.244939#>

stakeholders not to receive sufficient information of the accountability in the foundation.

These issues on accountability and reporting in foundation specifically and NPOs provide a fertile area to explore further the accountability through reporting practices in a developing country, especially Malaysia.

1.4 SIGNIFICANCE OF THE STUDY

This study attempts to contribute to theory, practice and policy. Regarding theory, the study provides insights into literature on NPOs especially on reporting and accountability practices in foundations.

This study will focus on understanding the reporting practices and the reasons for such reporting through interviews and document analysis of the foundation. Other studies in NPOs in Malaysia focused on the accountability and financial reporting practices by reviewing the annual report and financial statements (Nasir, Othman, Said, & Ghani, 2009; Zainon, Hashim, Yahaya, Atan, & Maria, 2013). The foundation may show reporting and accountability discharged that differs from NPOs established under the Societies Act 1966 since it has multiple choices of regulation such as the Trust Incorporation Act 1952, Companies Act 1965 or State Enactment. Besides the interview method, document analysis provides additional knowledge on the reasons for reporting in the NPOs and is guided by the framework of Unerman (2007) and Ebrahim (2003).

From the theoretical perspective, this study adds to the understanding of stakeholders' relationship with NPOs initiated by Ebrahim (2003b). To identify the information needed by stakeholders refers to four stages of SER model (Unerman,

2007). These frameworks lead to accountability reporting triangle that may apply to the foundation.

From the practical perspective, the findings of the study encourage the policymakers of developing countries to set separate regulations for foundations and NPOs. This is important to increase the consistency of reporting and provide better guidelines for foundations. This study also adds to the understanding of the current practice of foundations regarding organisational structure, reporting and accountability. Stakeholders and the public will indirectly have an overview of how foundations manage and disburse the funds according to the planned programmes and projects. Additionally, the findings create awareness among foundations of the importance of reporting as a medium to prove they are accountable to the various stakeholders.

1.5 ORGANISATION OF THE STUDY

The study consists of six chapters.

Chapter 1: **Introduction.** This chapter presents the background of the study, the problem statement, motivation, research objectives and research questions and significance of the study.

Chapter 2: **Literature Review.** This chapter explains the previous literature on accountability and reporting practices of the foundation is reviewed. Since studies of the foundation are still underdeveloped, literature on NPOs has been used as a general form of the foundation.

Chapter 3: **Research Methodology.** This chapter describes on research methodology, research design, data collection and analysis of data. It

also provides a discussion of the framework adapted from Ebrahim (2003b) and Unerman (2007).

- Chapter 4: **Contextual information.** This chapter states the background of foundation in developed countries, specifically Malaysia. Besides, the organisational profile of each foundation; (1) state-owned, Foundation A, (2) SRC-based, Foundation B (3) private-independent, Foundation C and (4) private-corporation, Foundation D has been explained.
- Chapter 5: **Findings, Analysis and Discussion.** The chapter presents the findings and discusses the results.
- Chapter 6: **Conclusion.** The chapter concludes the study with a discussion of the research contribution, limitations of the study and offers suggestions for future research.

1.6 CHAPTER SUMMARY

This chapter explains the background of the study, the research objectives and research questions, motivations and significance of the study, as well as the organisation of the study. In summary, this study explores the accountability practice of foundation through reporting mechanism. It is important to study foundations because although various types of the foundation have been established, there is yet to be proper regulation of this non-profit sector, especially in developing countries.

CHAPTER TWO

LITERATURE REVIEW

2.1 INTRODUCTION

The study explores the accountability practices of foundations. To accomplish this, literature on foundation and foundation-like entities are discussed. The reporting literature constitutes the main conceptual framework underpinning this study. This chapter is organised as follows. Section 2.2 will discuss the background of foundations followed by accountability and types of accountability in different sectors in section 2.3. The last section 2.4 discusses reporting as a mechanism of accountability.

2.2 BACKGROUND OF FOUNDATIONS

Foundations are known as formal types of NPOs, as they need to abide by legal frameworks and regulations. Othman & Ali (2012) categorised foundations as a type of NPOs in addition to charitable organisations, charitable trusts, and societies. Each entity has its target beneficiaries. Nevertheless, the major common trait of these entities is its ‘non-profit-seeking’. Collison, Bebbington, & Gray (2006) defined NPO as:

Any non-profit, voluntary citizens’ group which is organised on a local, national or international level. Task-orientated and driven by people with a common interest, NGOs perform a variety of services and humanitarian functions, bring citizens’ concerns to Governments, monitor policies and encourage political participation at the community level. They provide analysis and expertise, serve as early warning mechanisms and help monitor and implement international agreements. Some are organised around specific issues, such as human rights, the environment or health.