

Examining Financial Controls Practices among Religious Non-Profit Organisations: A Case Study of Malaysia

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Abstract

There have been many financial scandals associated with religious-based non-profit organisations (RNPOs), their involvement in unethical and wrongdoing has pressured non-profit organisations, especially religious-based NPOs (RNPOs) to start adopting highly transparent and accountable financial management practices. Despite many efforts to improve the RNPOs' service quality, their integrity has been tinted with many scandalous incidents of

funds embezzlement and corruption. Poor financial accountability and lack of legal requirements are argued to be the underpinning reasons for such financial atrocities occurring. With the absence of sound financial governance and comprehensive financial regulations, it has been impaired the government's ability to detect, prevent and correct RNPOs' financial misconduct. To prevent financial misconduct from repeatedly occurring, having cogent financial control practices will ensure the RNPOs upholding their accountability duties to the clients they have served. Therefore, the objective of this paper is to examine Malaysian RNPOs financial controls practices. In doing so, various religious-based NGOs' (i.e. Islam, Buddha, and Christian) representatives were interviewed, analysed, and appraised with Simon's (1994) control framework. The findings indicate that the RNPOs financial control practices are mediated by the virtue of the religions that they have adopted, the RNPOs' affiliation (i.e. local-based, foreign-based, and/or semi-government organisation), and the level of sponsorships and grants they have received.

Keywords: Religious Non-profit Organisations, Malaysia, Financial Controls, Financial Management

1. Introduction

Fraudulent cases are common occurrences, especially in commercial and private entities. However, fraudulent cases particularly fund embezzlement, not only occurred in private companies but seem to be frequently reported happen in religious-based organisations. According to Siino (2004), the paramount reason why embezzlement of funds or corruption cases occurred in religious-based NPOs (RNPOs) is mainly due to a lack of control and accountability mechanisms in their financial control systems. Siino (2004) study has pointed to several modern fraudulent cases that happened in churches in the United States of America. In one case, the absence of effective control mechanisms has become the impetus for embezzlement of 250,000 dollars of church's fund by the high-ranking priest that allegedly used the money to finance his vacation homes in California. In another incident, a pastor confessed to stealing donations totalling \$1.35 million, over 26 years from two churches he had served (Siino, 2004).

Embezzlement and corruptions cases were not prevalent practices that occurred in non-governmental settings, but it was not a strange occurrence at the public agencies level, substantially in Muslim majority countries. For instance, in 2011, an officer in one of Malaysia's State Islamic Councils was sentenced to four years in jail for embezzling the donation and zakat funds for personal gain (Utusan Online, 2011). The same incident repeatedly happened at the same State Islamic Councils, a Chief Executive Officer of that council was charged with corruption, allegedly receiving luxurious items since 2010 (Berita Harian Online, 2017). Similar incidents can be observed occurred in other Muslim countries, for example, in Pakistan, a recent case of irregularities of fund amounting to Rs3.67 billion out of Rs5.96 billion was found in a similar institution has been reported in 2020 by the Auditor General of Pakistan in their audit (Iqbal, 2020).

In spite of the organisational settings, neither non-profit nor public religious'-based institutions, financial misappropriations are possibly occurring when a good governance

practice is missing in the organisations' financial practices. Thus, it strongly suggests that cases of misappropriation and breaches of trust are prevalent in Muslim RNPOs and often such financial atrocities were linked to the inefficiencies and ineffectiveness of Muslim RNPOs in managing their funds (Roslan, Arshad and Mohd Pauzi, 2017). As a result, it is not a surprising revelation when there is a huge demand from the public for greater financial integrity and governance practices to be upheld by both government and non-governmental religious organisations.

Besides the lack of good governance practices among RNPOs, the current laws in Malaysia do not favour best financial practices to be incorporated in the NPOs' statutory disclosures. As highlighted by the Prime Minister's Department in Malaysia, most of the NPOs establishments in Malaysia are not regulated under the Companies Act statutes, therefore, leading them to have no public accountability, especially when it comes to financial reporting and auditing obligations as compared to those who registered under Companies Act. Consequently, it led to low financial disclosures among NPOs in Malaysia, including the RNPOs. For Non-profit organisations who have not registered their organisations with ROC (Registration of Company), they have the liberty to not publish audited annual reports for public viewing and as a result, only a handful of RNPOs have published their annual reports voluntarily, and with that said, they generally provide less information related to key financial policies and decision-making. With these statutory limitations and coupled with abysmal monitoring capabilities from the authorities, the RNPOs' financial performances and service quality are ineffectively available for the public's viewing and scrutinisation. Consequently, the public as the main stakeholder cannot ascertain whether the funds given to the RNPOs are utilised for the best use and free from being used for money laundering, fraud, and terrorism financing (The Star Online, 2017).

Nevertheless, the lack of statutory regulation on RNPOs' financial disclosure does not mean that the RNPOs do not have financial control mechanisms to monitor and manage their financial activities. On that point, therefore, this study attempts to understand the financial controls practices among the RNPOs in Malaysia. In so doing, the Simons' (1994) Four Levers of Control framework was used to appraise financial controls that have been practiced by the RNPOs in Malaysia. This paper starts with a literature review, follows by the discussion of the underpinning theory used to advocate the research issue and the methodology adopted in this study, and it continues with the findings and discussion section and lastly ending with a conclusion.

2. Literature Review

Literature on organisational efficiency and accountability has become the centre of discussion when it comes to examining public or governmental agencies' performances (See, Mellett, 1997; Brignall and Modell, 2000; Kaplan and Norton, 2001; Shende & Bennett. 2004; Siddique, 2005; Afifuddin and Siti-Nabiha, 2010; Mohd Noor, Abdul Rasool, Md. Yusof, Ali, and Abdul Rahman, 2015). Many studies have explored accountability and transparency in non-profit organisations, however, a lack of attention has been given to religious non-profit organisations (RNPOs), especially in the context of emerging economies, and consequently, it

impaired our understanding of these organisations, especially in Malaysia.

In the light of studies in accounting and accountability among NPOs in Malaysia, Management Control System (MSC) perspective has received much attention from the scholars (see Otley, 1999; Henri and Journeault, 2010; Kerr, Rouse and de Villiers, 2015; Rozaidy, Siti-Nabiha and Stocker, 2017). Only a handful of studies have explored accountability issues in religious-based organisations in Malaysia. Notably, a study done by Zain, Samad, Samsudin and Armia (2020) discussed the accounting practices among mosques in Malaysia. Despite that, studies on financial control mechanisms in non-profit settings are still scarce. One of the eminent studies that explored the issue of integrity and other control mechanisms in public settings was done by Mohd Baquir, Siti-Nabiha and Hasmin (2014). Mohd Baquir et al. (2014) study investigates how government-owned banks in Malaysia enhanced their ethical and integrity behaviours through the reinforcement of cultural and personnel control mechanisms. Mohd Baquir et al. (2014) study found that the bank's cultural controls encouragingly inculcate ethical and integrity culture among its members and the achievement was embellished through revamping the bank's personal control which originally was designed to strengthen the bank's good governance and ethical practices.

Generally, the focal theme in studying RNPOs is concerning the issue of funds' distribution transparency and operational effectiveness. The concern has something to do with the fact that the RNPOs' stakeholders (i.e., government, private donors, media, and the public at large) arguably concern the ability of the RNPOs in governing and managing their funds ethically (Ab Hasan, Othman, Ibrahim, Md Shah and Mohd Noor, 2015; Ahmad Razimi, Romle and Muhamad Erdris, 2016). The public concerns were not baseless, it was imbued with corruption and fraud cases that frequently featured in many recent headlines of newspapers and online articles.

Contrary to private corporations, RNPOs in Malaysia are not regulated with statutory requirements that require them to publish audited financial reports and critical information for public viewing and securitisation. Hence, in the absence of such critical monitoring regulations, the existence of an effective financial control mechanism is becoming eminent to safeguard the RNPOs from abusing public funds and concomitantly elevates the RNPOs' social image and financial integrity. As noted by Wu (2005), financial controls systems are believed to have the ability to refine an organisation's operational performance and potentially increase the ability in exposing fraudulent behaviours before it was too late to be internally corrected. The financial controls mechanism in this context includes corporate ownership and organizational structures, monitoring, and performance-based compensation (Virginia, Eleni, Dimitrios, & Chrysoula, 2009).

3. Theoretical Framework

As mentioned in the previous section, this study aims to appraise the RNPOs' financial control mechanisms applications by employed Simons' (1994) control framework. The control framework was chosen due to its methodical ability in explaining the function of a management control system in an organisation and has been extensively used in varying contexts such as research in performance measurements (Arachchilage & Smith, 2013; Jamil

& Mohamed, 2013; Bedford, 2015), environmental and sustainability (Arjalies & Mundy, 2013; Kerr et al., 2015) and organisational culture, strategy and innovations (Mohamed, Wee, Abdul Rahman & Abdul Aziz, 2014; Heinicke, Guenther, & Widener, 2016). Since Simon's control framework has been used in multiple research contexts, especially in cultural context, which is much related to understanding belief and cultural elements in the religious-based phenomenon. Hence, the application of his framework will provide a comprehensive view of understanding the interplay between financial controls and belief systems.

In general, the construction of Simons' (1994) Four Levers of Control framework (refer to Figure 1) was based on four control systems namely boundary system, beliefs system, interactive control system, and diagnostic control system. Simon's first control mechanism, beliefs systems can be illustrated through the ability of the top managers to communicate the objective of the organisation's establishment to its members. The top managers are required to systematically imprint the organisational members with the organisation's beliefs systems -i.e., values, purpose, and direction. In most cases, the organisation's beliefs systems were usually embedded in the organisation's credos, mission statements, or statements of purpose. Meanwhile, for boundary control, Simon (1994) defines a boundary system as a formal system developed by the organisations to engrave the rules of dos and don'ts that need to be followed by its members. Practically, a boundary system outlines the types of behaviours that the organisation's members need to avoid while at the same time bestowing them the liberty to engage with creativity in achieving organisation's pre-determined objectives. The code of conduct is a prime example of a boundary system that can be observed in most organisations.

A diagnostic control system can be described as a formal feedback system used to evaluate, motivate, and compensate the organisation members' achievements in accomplishing pre-determined targets and sets of goals. The paramount advantage of an appropriate diagnostic control system is the ability to track and correct conspicuous deviations from the pre-set performance standards. Finally, an interactive control system is a set of control mechanisms used to stimulate the emergence of new strategies and ideas through encouraging active involvement and effective communications activities among organisational members, such as open dialogues. Simon's (1994) four levers of control framework works cohesively in stripping together both behavioural and operational spectrums of organisational control framework. From the behavioural perspective, the beliefs systems and interactive control systems are powered through the conversion of positive encouragement in motivating employees, meanwhile, on the operational perspective, the diagnostic control mechanism synergistically reduced misdirected behaviours by steering the employees with a well-fitting set of code of conducts. With such methodical features, therefore, Simon's (1994) controls framework served as a befitting analytical framework in appraising Malaysian RNPOs' financial control practices.

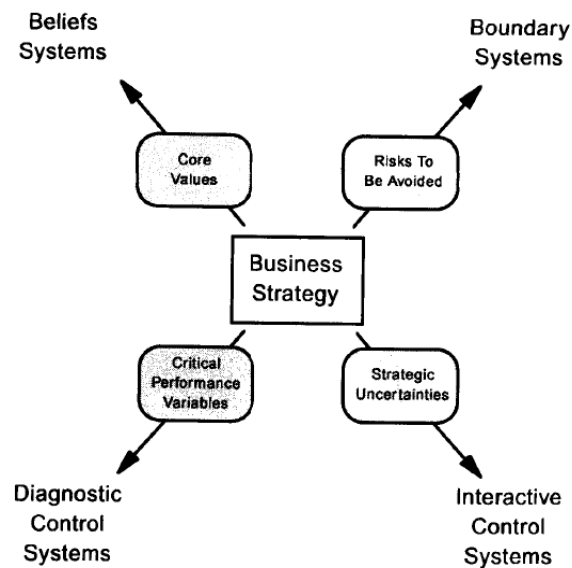


Figure 1. Controlling business strategy: Framework for analysis

Source: Simons (1994)

4. Method

In this research, a qualitative approach is considered as an appropriate method to investigate the research issues of this study. This research aims to understand the RNPO’s financial controls practices following Simons’ Four Levers of Control framework. Thus, the process of understanding the research issue is not easy to be fully examined only by searching on the surface, as Gillham (2000) commented, it needs “to get under the skin” of the organization to uncover the informal reality which can only prevail from within. To examine the reality from within, the researcher is required to view the reality from the perspective of those involved. Thus, to understand the research issue from a qualitative view, this approach requires triangulation of data from multiple sources such as semi-structured and unstructured interviews, informal conversation, observation, review of internal documents, published reports or statements, and press releases (Yin, 2003).

To advocate the research issue, four RNPOs were chosen as the subject of study. The establishment of RNPO’s as the subject of study was based on three main categories: - (1) the organisation must represent one of the four major religions in Malaysia – i.e. Islam, Buddhism, Christianity, and Hinduism; (2) it needs to be operated for several years; and (3) the objective of the establishment is based on serving the values or teaching of the religion that its represented. After many requests being made, four RNPOs that fit with the three categories were identified. One RNPO is based in Sabah (Christianity), two in Kuala Lumpur/Selangor (Islam and Buddhism), and one in Penang (Hinduism). Since this research is preliminary research, only one to two key officers were interviewed to capture the essential evidence of the main issues. The research used semi-structured interviews since the method gives a comprehensive idea or concept about the subject of inquiry. The interview was conducted in January-August 2019 with face-to-face meeting sessions. The interview lasted

about one to one and a half hours. In analysing the data, the interview was transcribed and coded into a thematic style of analysis.

The following is a brief background of the four RNPOs that have been examined in this study. To preserve the confidentiality agreement with organisations, only a minimum and decent information about the RNPOs will be shared and revealed. The acronym of RNPO A, B, C, and D was used in depicting the researched organisations. RNPO A is an affiliated partner of an international Islamic humanitarian and development NPO founded in Europe in the 1980s with over 100 offices in more than 45 countries. RNPO A was established in Malaysia in early 2000, with its local operation office located in Selangor, Malaysia. The main objective of RNPO A is to continue the humanitarian aid in the Asia-Pacific region, carrying both roles as a fundraising office (for local and international projects) and field office (for implementing local projects). RNPO B is a Christian NPO established in Sabah and is registered with the Companies Commission of Malaysia in early 2000. RNPO B has its origins as a charity founded and operated by one of the world-leading Christian women congregations. The focus of RNPO B is on women, children, and youth who have limited access to educational opportunities.

Meanwhile, RNPO C is a local Buddhist NPO established in the early 1950s in Kuala Lumpur, Malaysia. RNPO B is established with a close connection with one of the world-leading Buddhist organisations that originated from one of the Chinese populous countries. RNPO C is a volunteer-based, spiritual as well as welfare organization. Its mission has been focused on giving material aid and inspiring love and humanity in both the givers and receivers ranging from the field of charity, medicine, education, environmental protection, as well as the promotion of humanistic values and community volunteerism. Lastly, RNPO D is a Penang-based Hindu statutory body. RNPO D establishment is based on the government's statutory law, but the government's involvement in RNPO D is mostly related to financial and administrative activities, but they have absolute authority in handling their religious activities and managing their heritage assets. RNPO D's main role is to administer the endowments placed under its administration such as land, properties, burial grounds, temples, and the money is given or to be given for the benefit of the Hindu community in Penang.

The respondents who participated in the interviews vary for each of the RNPOs. RNPO A was represented by their Chief Executive Officer along with his Special Officer. Both respondents for RNPO B and D were their Director and Executive Director, respectively. Finally, RNPO C was represented by its two long-time volunteers who are actively engaged in RNPO C's activities.

5. Results

The findings in this study were derived from the interview transcriptions and documentation reviews. The findings have been analysed according to Simon's Four Levers of Control framework: (1) beliefs control system, (2) boundary control system, (3) diagnostic and interactive control systems.

5.1 Belief Control System

A belief system is an ideology or set of principles that help us to interpret day-to-day reality. It comes in many various forms and commonly driven by religion, political affiliation, philosophy, or spirituality, among many other things. However, the beliefs system is shaped and dictated by many factors. In organisational context, a beliefs system is a formal system used by the top managers in organisations to define, communicate and reinforce systematically to provide basic values, purpose, and direction for the organization (Simon, 1994). Similar to a private organisation, a religious-based organisation's beliefs system was established based on specific values and principles, and that beliefs system dictates how the RNPOs organise their operational activities and influence strategic decision-making. The finding shows that all four RNPOs in this study are established based on two main beliefs systems; firstly, to uphold their religion's values and secondly, serving the wellbeing of their followers/devotees/worshippers. Moreover, the findings also revealed that the interpretation of RNPOs' beliefs systems are not fixed, and it was dynamically interpreted according to current social, economic, and cultural conditions. For instance, RNPO D originally established to serve one particular group of ethnics that migrated from southern Asia, however, after decades been operated and assimilated with diverse ethnicities in Malaysia, the approach has been changed from serving only to one particular ethnic to serving all ethnics as part of humanitarian values. Changes in approach are crucial and it was part of survival strategy to continue relevant and expanding financial accessibility. The study shows that the beliefs system plays a vital role in shaping the RNPO's identity and at the same time function as the main reference in developing RNPO's control system attributes, especially in developing boundary control.

5.2 Boundary Control System

In managerial practices, boundary control systems are a type of control mechanism that dictates general standards that govern the employees' behaviour in managing finances and operational activities (Simon, 1994). In the RNPOs context, boundary control is a code of conduct that the members of the organisation agree to uphold while they work with or at the organisation. For instance, dressing code, speak a certain way in front of customers or clients, worship rituals, etc. This type of restriction is a common practice in most organisations and it was driven by the values or beliefs system that inhabitant in one's organisation. Hence, the boundary control practices are more prevalent among religion-based non-profit organisations because their identity is banded to the sacred values and principles of the religion they represented.

In this study, all four RNPOs have a well-structured and formal code of conduct embedded in their day-to-day operation. However, a more stringent and systematic code of conduct can be observed in RNPO A, B, and C as compared to RNPO D. For instance, in RNPO B, members' ranks are distinguished through colour of the shirt they wear. The new member is required to wear white-coloured shirt, then after series of spiritual cultivation processes and ceremonies, the shirt's colours eventually change from white to several other colours and finally to a grey colour. On most occasions, only those who wear grey coloured shirts (i.e.,

knowledgeable/senior members) can hold positions or be a tour guide for the public viewers/visitors. The reason behind this practice is to ensure only correct and record-based information are conveyed and at the same time to reduce misconception and misinterpretation of the real intention of initiatives/practices/activities conducted by the organisation. Besides that, all RNPOs in this study have very stringent financial procedures installed in their organisations. All RNPOs have a separate accounting/finance department in their organisations, the existence of an independent accounting/finance department is to ensure the organisations' financial transactions are safely safeguarded. Three out of four RNPOs (A, B, and C) hired external auditors to audit the organisations' yearly financial statements and most of the donations were received and transferred via online banking application. This was done to ensure the transparency of the donations' collection. For RNPO D, their boundary control is much stringent as compared to the rest because their establishment is a semi-government structure, which requires them to systematically follow the government's financial control procedures and subject to both internal and external auditing compliance mandated by the government's laws.

These kinds of practices that have been observed in this study can be understood from the basis that all three RNPOs (A, B, and C) are foreign-linked RNPOs or indirectly affiliated with foreign-linked RNPOs that open their bases in Malaysia. A well-structured code of conduct is common among multi-national RNPOs, this is because tight boundary control will maintain the organisation's legitimacy and reputation as accountable and trustworthy organisations. After all, any unethical conduct that occurred in big corporations will get severe public scrutiny. Moreover, well-established multi-national RNPOs often receive hefty financial sponsorships or grants from big corporations and governments, thus, any unethical actions or misconducts, especially regarding financial wrongdoings will cause them to lose their sponsorships and be subjected to severe legal charges against them.

5.3 Diagnostic and Interactive Control Systems

According to Simon (1994), diagnostic and interactive control systems are two sets of controls mechanism that top management uses to develop the management-by-exception systems that managers use to monitor the achievement of their business strategy, which later on allows the organization to position itself for future. In simpler terms, diagnostic control provides the members of the organisation with a set of KPIs (Key-Performance-Indicators) or targets to archive and used interactive control to empower the employees' capability or creativity to archive those KPIs/targets. These two type controls are common in private organisations but hardly can be seen in the non-profit organisation since most of the members who worked for the non-profit-based organisation are voluntarily in nature, and this type of group commonly are not reward-based individuals. Surprisingly, the findings show that all four RNPOs have both diagnostic and interactive control systems in their administration system. Based on the observations and analysis, there are two main reasons why all RNPOs in this case study have adopted and implemented both diagnostic and interactive controls in their organisations.

Firstly, all three (RNPO A, B, and C) are foreign-linked or affiliated RNPOs and their

financial and operational performance are highly structured and managed by their parent organisations or headquarters. This can be observed through their published materials such as brochures, print-ups, books, magazines, and pamphlets. In these documents, they have extensively disclosed their KPIs and compared it with previous achievements, especially information related to financial activities, such as where they get the money/donations, where they spend it, and what are the outcomes from the spending. In addition, for RNPO D, the diagnostic control is not as extensive as the rest because a certain percentage of their funds are coming from government grants, and on top of that, they were sufficiently funded by the assets (e.g. shop lots, houses, lands, and religious consultations) that have been accumulated for more than decades.

Secondly, the ability to all have a systematic administration structure put in place at their organisation is due to having sufficient financial resources, which enables them to hire full-time employees in managing their administrative works, especially financial and accounting activities. A combination of sufficient workforce and well-financial resources have made the interactive control is possible to be implemented by all RNPOs in this study. An interactive control is a type of control that links employee's creativity/performance with rewards expectancy, a link that is hard to be found in small RNPOs. In small-scale of RNPOs, most of the administrative works were done voluntarily. In addition, in RNPO A and B, full-time employees' performance was measured and rewarded yearly as they have sufficient financial resources to do so. However, despite these employees are fully paid administrative staffs, working in religious-based organisation indirectly have a significant effect of their working ethics, especially in voluntarism perspective, whereby many of them are willing to donate part of their time to partake with the organisation voluntarily and humanitarians activities for free.

In a nutshell, similarly to private-profit companies, non-profit organisations do have financial control systems installed in the organisations. Both sectors developed and implemented financial control mechanisms to ensure the funds are sustainably managed as required by the laws and the organisation's financial goals. The findings indicate that the RNPOs financial control systems are mediated by the virtue of the religions that they have adopted, the affiliation of the RNPOs (i.e., local-based, foreign-based, and/or semi-government organisation), and the level of sponsorships and grants they received. These three factors played the most important role in determining the development of RNPO's financial control practices.

6. Conclusion

In this era of unavoidable transparency, countless watchdogs, and high expectations from funders and donors, it is becoming more important to ensure the financial integrity of any organization. Especially in the case of RNPOs whose operations are mostly funded by the public, the public is interested to know whether their altruism investments made onto these organisations are wise. Thus, to provide a broader view of the operations and governance of RNPOs in Malaysia, this study provides evidence on the financial control practices among RNPOs in Malaysia through employing Simons' (1994) Four Levers of Control framework.

(i.e., beliefs system, boundary system, diagnostic, and interactive control system). The findings outputs could serve as an important reference and assistance for the government or the rule makers in strengthening the regulations to govern these institutions. Moreover, the research findings may be used as guidance to propose new financial mechanisms to supervise and monitor the financial operations of RNPOs in Malaysia.

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