

# Analyzing Disclosure Practice of Religious Nonprofit Organizations using Partial Disclosure Index

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**Abstract**—This study examines the relevance of disclosure practices in improving the accountability and transparency of religious nonprofit organizations (RNPOs). The assessment of disclosure is based on the annual returns of RNPOs for the financial year 2010. In order to quantify the information disclosed in the annual returns, partial disclosure indexes of basic information (BI) disclosure index, financial information (FI) disclosure index and governance information (GI) disclosure index have been built which takes into account the content of information items in the annual returns. The empirical evidence obtained revealed low disclosure practices among RNPOs in the sample. The multiple regression results showed that the organizational attribute of the board size appeared to be the most significant predictor for both partial index on the extent of BI disclosure index, and FI disclosure index. On the other hand, the extent of financial information disclosure is related to the amount of donation received by RNPOs. On GI disclosure index, the existence of an external audit appeared to be significant variable. This study has contributed to the academic literature in providing empirical evidence of the disclosure practices among RNPOs.

**Keywords**—disclosure, index, partial, NPOs, religious

## I. INTRODUCTION

DISSEMINATION and communication of information for knowledge guide the stakeholders in decision making. For this reason, disclosure is often an attempt used to disseminate and communicate the information. There is also a particular need for information to be disclosed in order to improve the accountability and transparency. Many nonprofit organizations (NPOs) disclosure studies focus on charity sectors [1-4] and education sectors [5-7], but little concern on disclosure practices over religious nonprofit organizations (RNPOs) or so-called faith-based organizations (FBOs).

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This study focuses on the disclosures of information that RNPOs ought to disclose and the effects of disclosure generally on the organizational attributes (Saxton, 2011), capacity and governance. This study uses new approach which examines the extent of disclosures using partial disclosure index. Taking into account the fact that information related to RNPOs is not regulated either in the form of contents or presentation format, the application of partial disclosure index could be a leading mainstream indicating the codes of best practice for RNPOs disclosure.

This study will continue with the statutes dealing with NPOs in Malaysia, review of past literature and will then proceed to the empirical stage of variable measurement, sampling, data analysis and discussion of results. The final part of this paper presents conclusion, limitations and suggestions for future research.

## II. STATUTES DEALING WITH NPOS IN MALAYSIA

The main statutes dealing with establishment and regulation of nongovernmental organizations (NGOs) in Malaysia are the Societies Act 1966 (Act 335) & Societies Regulations 1984 and the Income Tax Act (ITA) 1967 issued by the Inland Revenue Department (IRD). Some NPOs may register under specific Acts (e.g. the Sports Commission Act or the University and University Colleges Act 1971). Otherwise, they can register themselves under the Companies Act. NGOs in the form of company are incorporated as a company limited by guarantee (known as "charitable corporation") governed by the Companies Act 1865.

The principal act governing the activities and operations of the societies registered under the ROS is enforced by the Societies Act 1966 (Act 335) & Societies Regulations 1984. The regulations made there under, are known as Societies Regulation 1984. Since the enactment of the Societies Act 1966 (Act 335), numerous amendments have been carried out, and the most recent in 1998 [the Societies (Amendment) Act 1998].

All NGOs that intend to participate or organize any activity on behalf of the society must register with the relevant authorities. The ROS's primary function is only concerned with the registration, control and monitoring of registered societies throughout Malaysia so that they do not adversely affect the security, peace, public order, welfare or morality in Malaysia. The ROS requires the registered societies to submit Form 9 within 60 days after holding its Annual General Meeting (AGM).<sup>1</sup>

<sup>1</sup> Section 14(1) of the Societies Act 1966 (Act 335) & Regulations

In dealing with the accountability and accounting, the registered societies are required to submit the accounts of the last financial year together with a balance sheet showing the financial position at the close of the last financial year of the society. The accounts can either be audited by the societies' internal auditor or an external auditor.

NGOs that form as "charitable corporation" are governed by the Companies Commission of Malaysia (CCM). The CCM is responsible in the registration, supervision and control the activities of these charitable corporations. A newly incorporated charitable corporation must convene an AGM within 18 months from the date of incorporation. Following an AGM, it must lodge its annual returns and audited accounts with the Companies Commission in a timely manner.

In relation to financial reporting practices for NPOs registered with ROS, there are no particular regulatory requirements in Malaysia except for the brief requirements on the need to furnish the Form 9 together with the annual returns to the ROS. Due to less stringent regulatory requirements, the information reported by the NPOs can be insufficient or misrepresented for effective monitoring and regulating of NPOs [8].

### III. REVIEW OF LITERATURE

The disclosure of information is essential for the organizations to capitulate information for them to be accountable to their stakeholders [9]. The stakeholders can then evaluate the effectiveness and efficiency of the organizations in which the latter function their activities. In the profit organizations, disclosure studies presume that there is information asymmetry between managers and stakeholders [10, 11]. However, this information asymmetry can be eliminated by means of disclosure for information. In NPOs, board of trustees has incentives to make more information available to stakeholders. This is because they have supremacy to enhance the transparency of the organizations by means of quantitative and qualitative disclosure of information.

In addition, disclosure of information can enhance donors' perceptions from which donations are increased if they gain assurance on the information provided to them [12, 13]. Therefore, the financial information and governance information furnished by these organizations has been the central thrust of many previous studies in relation to disclosure of information [14-16]. In particular, the disclosure of information considers voluntary information provided in the annual reports [17], including the service efforts and accomplishment [4, 13]. The originality of this study is the analyzing of disclosure for information using partial index for RNPOs disclosure for information. The means of communication through which the disclosure is carried out is also analyzed. This is because timely and publicly accessible filings will provide a first step toward reducing the information asymmetry between the management of RNPOs and the donors [18].

Disclosure of information by NPOs is crucial for many reasons. Among the reasons are: (i) information disclosed can be used by stakeholders to evaluate the effectiveness and efficiency of the organizations, (ii) the disclosures of

information can potentially improve stakeholders' perceptions, and thus enhance the accountability and transparency of the organizations. Indeed, a considerable literature has developed that examines the extent of disclosure and the organizational attributes. The literature on NPOs suggests that several key organizational attributes influence the extent of disclosure to which the organizations should comply. However, the attributes selected must meet the following five conditions [19]. First, the attribute should likely be associate with mandatory disclosure either on a priori assumption or on a theoretical consideration. Second, it should be easily measured for the purpose of statistical analysis. Third, the attribute should be able to facilitate the classification of the sample. Fourth, data should be available on those organizational attributes. Finally, the attribute should be relevant to the socio-economic of the country under study. The selected organizational attributes in this study are the financial performance, the board size, the presence of an internal audit, the existence of an external audit and the organizational size.

#### A. Financial Performance

Economic theory and empirical evidence suggest that the financial performance of an organization is likely to positively influence the disclosure practices. There have been quite a number of previous studies that found a positive relationship between the extent of disclosure practices and financial performance [17, 20-23]. Most RNPOs depend on contributed income such as donations from donors and grants from foundations. This shows that disclosure of financial information in the financial statements is very important since it can influence a potential donor's decision to donate. Previous studies provide evidence that financial reports play a role in donation decision [2, 21, 24]. Through financial reports issued by the RNPOs, the existing and potential donors can obtain necessary information for them to assess and evaluate the performance efficiency through the missions of RNPOs. Therefore, it is hypothesized that:

*H<sub>1</sub>: Financial performance of RNPOs is positively associated with its extent of disclosure practices.*

#### B. Board Size

Much of the literature on NPOs emphasizes the role of board of directors or board of trustees. The board has the ultimate fiduciary duty for approving financial reports for disclosure purposes. It is always assumed that the extent of disclosure practices by RNPOs is influenced by the size of the board members. A number of studies (see for example, [14] and [15] provide empirical evidence that support the positive association between board size and the extent of disclosure practices. Larger size of the board of trustees may also be important because of the increased in the levels of fundraising and improved performance. However, opposing evidence was also found in studies relating performance to board size [14, 25] and disclosures to board size [5]. Further empirical investigation is therefore needed. Given the strong theory to support a positive relationship, it is hypothesized that:

*H<sub>2</sub>: RNPOs with larger board size disclose more information to a greater extent than those with small board size.*

### C. The Presence of an Internal Audit

It is suggested that internal auditors play a major role in the disclosure policies and practices of their clients. Specifically, the analyses by previous studies in corporate annual reports indicate that audit quality is influenced by the size of auditing firm [26]. The internal auditors have an ability to discover a material error and they have willingness to properly report the disclosure of information in the annual reports. This leads this study to the development of the following hypotheses related to the presence of institutional donors and the disclosure of information:

*H<sub>3</sub>: The presence of an internal audit is positively related to the extent of disclosure practices by RNPOs.*

### D. The Existence of an External Audit

Given the function of an independent audit within the non-profit context, [27] and [16] argued that the existence of an external audit may improve internal control and thus regarded it as an effective monitoring device for improving the extent of disclosure for information. They found that the existence of an external audit is significantly related to the adoption of mandatory disclosure measures. Similarly, [28] provides support that the existence of an external audit minimizes reporting problems and acts as a tool for quality financial reporting that enhances accountability and transparency. Hence, the following hypothesis is proposed:

*H<sub>4</sub>: The existence of an external audit is positively associated with the extent of disclosure practices by RNPOs.*

### E. Organizational Size

The association between the organizational size and the extent of disclosure is supported by empirical evidence. Organisational size, as measured by either the total assets or natural log of total assets [5, 29, 30], total revenues [31-34] or total number of membership [35, 36], persistently found to be positively and significantly associated with the extent of disclosure levels. This implies that larger organizations have better disclosure practices. Although a consistent positive significant association between organizational size and disclosure levels has been reported, it is apparent that a wide variation in results also exists. [5] in their study of 100 United States higher education institutions, it was found that organization larger in size and audited by the state, type of the organization either the public or private disclosed more information. On the same year, [37] found that organizational size as an important determinant of financial reporting quality rather than the audit-firm tenure.

## IV. METHODOLOGY

### A. Sample and Data Collection

The sample consists of 83 RNPOs registered with the Registry of Societies (ROS) for the financial year 2010. This study divided the sample according to the presence of religious practices in Malaysia from Islam, Buddhism,

Hinduism, Christian and others (Sikhism, Daoism and Confucianism). A summary of the selected societies according to religious practices are shown in Table I.

TABLE I  
 SAMPLE SELECTION

No.	Category of RNPOs	Numbers	Percentage (%)
1.	Islam	14	16.9
2.	Buddhism	41	49.4
3.	Hinduism	4	4.8
4.	Christian	14	16.9
5.	Others (Sikhism, Daoism and Confucianism)	10	12.0
TOTAL		83	100

The largest or high proportion of RNPOs was from Buddhism (41; 49.4%), followed by Christian and Islam (14; 16.9%), Others (10; 12%) and the least of Hinduism (4; 4.8%).

### B. Partial Disclosure Index (PDI)

The extent of disclosure practices disclosed in the annual reports of RNPOs in this study is measured based on adapted Charitable Organizations Reporting Index (ChORI), a self-developed index by [38]. The identification of items to be included in the index is guided by the review of prior studies relevant to disclosures in annual reports of charity organizations which have in common characteristics with RNPOs. The initial index of ChORI allows the researcher to build three partial indexes to analyze the information contained in the annual returns of RNPOs. The partial index in this study consists of altogether 59 items grouped into three subcategories – 11 items of Basic Information (BI), 30 items of Financial Information (FI) and 18 items of Governance Information (GI). The Cronbach's alpha has been carried out in order to check for the reliability of internal consistency of the index. The consistency of the index is good, the value above the threshold level of 0.80 [39]. The full disclosure index (PDI) can be obtained from the author upon request.

### C. Measurement of PDI, Independent and Control Variables

The measurement of score for partial indexes used in this study is based on a dichotomous measure where an item scores a one if it is disclosed and a zero if it is not disclosed. For each organization, the extent of disclosure is calculated as a ratio of the actual score awarded to the organization divided by the maximum potential score awarded to that society. There are three indexes computed from Basic Information Index (BI), Financial Information Index (FI) and Governance Information index (GI). The extent of disclosure for each index is calculated as follows:

$$PDI_j = \sum_{i=1}^{n_j} Item_i$$

The total score  $PDI_j$  represents the total score awarded to each organization and it is an unweighted total disclosure.

The unweighted scores are used in this study because of the assumption that each item disclosed by an organization is of equal importance to the stakeholders [40]. Since the content of the reports were analyzed based on three subcategories, the researcher calculated the partial index for each, and aggregating the results to obtain the total index.

For other independent variables and control variable, data were collected from the annual returns of the participating organizations. Data on financial performance (FINP) is measured by natural log of total donations and natural log of board members represents the board size (BSIZE). Further, a binary scheme was used to denote the presence of the internal auditor (INTAUD) and the external auditor (EXTAUD). These dummy variables were coded "1" to indicate existence and "0" to indicate non-existence. The control variable in this study was represented by the organizational size (ORGSIZE) and it is measured by the log of total revenues.

## V. ANALYSIS AND RESULTS

### A. Descriptive Analysis

This section presents and discusses the results of various descriptive statistics in three parts: the first part discusses the overall level of disclosures in annual reports; the second part discusses the results in relation to the extent of disclosure on basic information, financial information and governance information. In Table II, the descriptive results are included for both partial indexes and for the variables used in the model.

TABLE II  
DESCRIPTIVE STATISTICS

Variables	Mean	Std. Deviation	Median	Lower Quartile	Upper Quartile
BI	0.4808	0.11407	0.5455	0.18	0.82
FI	0.3004	0.11037	0.3000	0.00	0.57
GI	0.3360	0.04664	0.3333	0.28	0.44
Total Revenue	120493.24	225143.07	32631.7	0.00	1144143
Total Donation	100079.17	201753.77	15758.0	0.00	1123362
Board Size	11.76	6.042	11	3	35

\* Data in Ringgit Malaysia (RM) for total revenue and donation.

Regarding the partial disclosure indexes as shown in Table II, all the mean value obtained for each PDI for the RNPOs did not surpass the "approved" mean value of above 0.50. The highest mean value reached was for BI index was at 0.4808 and the lowest mean value for FI index was 0.3004. It is also pointed out that the highest number of board members is 35. The average total revenue obtained was RM120,493.24 and RM100,079.17 for total donation received for the financial year 2010.

### B. Correlation Matrix

Prior to conducting the multivariate tests of multiple regression analysis, the correlation matrix of the dependent, independent and control variables in the study was performed. The results of the correlation matrix show a number of significant correlations. Table III displays the results.

TABLE III  
PEARSON CORRELATION MATRIX OF VARIABLES AFFECTING BI DISCLOSURE INDEX

n= 83		BI Disc Index	Ln FINP	Ln BSIZE	Ln ORG SIZE
BI Disc Index	Pearson Correlation	1.000	.237*	.536**	.349**
	Sig.		.031	.000	.001
Ln FINP	Pearson Correlation	.237*	1.000	.225*	.556**
	Sig.	.031		.041	.000
Ln BSIZE	Pearson Correlation	.536**	.225	1.000	.856**
	Sig.	.000	.041		.000
Ln ORGSIZE	Pearson Correlation	.349**	.556**	.357**	1.000
	Sig.	.001	.000	.001	

\*\* . Correlation is significant at the 0.01 level (2-tailed).

\*. Correlation is significant at the 0.05 level (2-tailed).

Table III shows the correlation between the extent of BI disclosure (BI disclosure index) and the independent and control variables. The significant correlations at the 0.01 level (2-tailed) included the LnFINP ( $r = .349$ ,  $p = .001$ ) and LnBSIZE ( $r = .536$ ,  $p = .000$ ). The most notable strong relationship and significant correlation at the 0.01 level (2-tailed) also existed between LnFINP ( $r = .556$ ,  $p = .000$ ) and LnORGSIZE. The correlation between the financial performance (LnFINP) with the BI disclosure is noteworthy even though indicating weak relationships ( $r = .237$ ). This is because this outcome shows that the extent of basic information disclosure made by RNPOs potentially influence a donor's decision to donate, thus enhance the total donations. In other words, donors want information on whether funds donated are actually utilized for charitable activities and programs. This will further induce them to donate in the future. Table IV presents the correlation of FI disclosure.

TABLE IV  
PEARSON CORRELATION MATRIX OF VARIABLES AFFECTING FI DISCLOSURE INDEX

n= 83		FI Disc Index	Ln FINP	Ln BSIZE	Ln ORG SIZE
FI Disc Index	Pearson Correlation	1.000	.449**	.450**	.478*
	Sig.		.000	.000	.001
Ln FINP	Pearson Correlation	.449**	1.000	.225*	.556**
	Sig.	.000		.041	.000
Ln BSIZE	Pearson Correlation	.536**	.225	1.000	.856**
	Sig.	.000	.041		.000
Ln ORGSIZE	Pearson Correlation	.450**	.556**	.357**	1.000
	Sig.	.000	.000	.001	

\*\* . Correlation is significant at the 0.01 level (2-tailed).

\*. Correlation is significant at the 0.05 level (2-tailed).

All positive correlations in Table IV indicate direct relationship between the organizational attributes in the study and the extent of FI disclosure. Similar with BI disclosure, significant correlations at the 0.01 level (2-tailed) included the LnFINP ( $r = .449, p = .000$ ), LnBSIZE ( $r = .450, p = .000$ ) and also LnORGSIZE ( $r = .478, p = .001$ ).

TABLE V  
PEARSON CORRELATION MATRIX OF VARIABLES AFFECTING GI DISCLOSURE INDEX

n= 83		GI Disc Index	Ln FINP	Ln BSIZE	Ln ORG SIZE
GI Disc Index	Pearson Correlation Sig.	1.000	.308**	.057	.338**
Ln FINP	Pearson Correlation Sig.	.308**	1.000	.225*	.556**
Ln BSIZE	Pearson Correlation Sig.	.057	.225*	1.000	.357**
Ln ORGSIZE	Pearson Correlation Sig.	.338**	.556**	.357**	1.000

\*\* . Correlation is significant at the 0.01 level (2-tailed).

\* . Correlation is significant at the 0.05 level (2-tailed).

Contrast with BI and FI disclosure index, LnBSIZE ( $r = .057, p = .611$ ) appeared to be not significant with the extent of GI ratio. The only relationship that can be considered strong relationship existed between LnFINP and LnORGSIZE  $r = .556, p = .000$ . The findings from the correlation matrix presented in Table III, IV and V assisted the researcher in this study to determine which variables and directions to consider before performing the multivariate analysis of the multiple regressions.

According to [41], careful attention should be given to two variables in the same analysis when their correlation is 0.7 or higher. Other studies, regarded a level of 0.8 or 0.9 as indicating a significant problem [42]. The correlation matrix in Table III, IV and V show no correlation between two explanatory variables exceeded the level of 0.6. Thus, Pearson's correlation coefficient suggests no collinearity problems between variables: partial disclosure index (PDI) and LnFINP, LnBSIZE or LnORGSIZE.

### C. Multivariate Analysis

The model in the study is a simple ordinary least squares (OLS) regression equation run with all the variables included. The model proposed for regressions in this study is:

$$PDI = \beta_0 + \beta_1 FINP + \beta_2 BSIZE + \beta_3 INTAUD + \beta_4 EXTAUD + \beta_5 ORGSIZE + \varepsilon$$

where,

**PDI** = Partial Disclosure Index

**FINP** = Financial Performance (measured by total donations)

**BSIZE** = Board Size, actual number of board members

**INTAUD** = Internal Audit, 1 if yes, 0 otherwise

**EXTAUD** = External Audit, 1 if yes, 0 otherwise

**ORGSIZE** = Organizational Size (measured by total revenues)

$\varepsilon$  = Error term,  $\beta_0$  = the intercept

Multiple regressions were estimated using three models for each partial disclosure indexes with the independent variables and control variable. The possible existence of multicollinearity was tested in this study. The computation of Variance Inflation Factor (VIF) observed for all independent variables were below 2.0. Thus, these results support the lack of presence of multicollinearity in the research model. The tests of normality, given the results of the Kolmogorov-Smirnov statistic on the dependent variable suggest symmetrical distribution<sup>2</sup>, thus no violation of the normality assumption. Table VI depicts the Adjusted R<sup>2</sup> (coefficient of determination), F-ratio, beta coefficients and t-statistics for the model and summarizes the multiple regression results of BI disclosure index.

TABLE VI  
MULTIPLE REGRESSION RESULTS FOR BI DISCLOSURE INDEX

Variables	Coefficient	Std Error	Beta t-values	Sig.
Constant	3.344	0.056	0.189	0.001
FINP	0.006	0.009	0.114	0.526
BSIZE	0.100	0.020	0.524	0.000*
INTAUD	0.024	0.024	0.105	0.306
EXTAUD	0.051	0.029	0.178	0.083
ORGSIZE	0.012	0.010	0.221	0.238

\* significant at 1% level

Only one variable, the board size was significant at the 0.01 level in the regression model for BI disclosure index. This implies that large board sizes are more inclined to adhere to disclosure practices. Other variables of financial performance, existence of internal and external audit and organizational size were not significant. Results of Adjusted R<sup>2</sup> indicate that only 32.8% of these variables are explained. This means, there could be other variables that could explain the extent of disclosure. Table VII shows the regression results for FI disclosure index.

TABLE VII  
MULTIPLE REGRESSION RESULTS FOR FI DISCLOSURE INDEX

R <sup>2</sup> = 0.435
Adjusted R <sup>2</sup> = 0.399
F Significance = 0.000
n=83

<sup>2</sup> The value of Kolmogorov-Smirnov statistic has a significant value of 0.2.

Variables	Coefficient	Std Error	Beta t-values	Sig.
Constant	0.147	0.052	2.851	0.006
FINP	0.000	0.009	2.971	0.004*
BSIZE	0.053	0.018	0.290	0.004*
INTAUD	0.025	0.022	0.109	0.258
EXTAUD	0.051	0.029	0.178	0.083
ORGSIZE	0.071	0.027	0.254	0.010

\* significant at 1% level

For FI disclosure index, the most significant variables are the financial performance (total donations) and board size with the same p-value of 0.004. It is slightly different from BI disclosure index, the results for FI disclosure index added one more significant variable. Table VIII presents the multiple regression results for GI disclosure index.

TABLE VIII  
MULTIPLE REGRESSION RESULTS FOR GI DISCLOSURE INDEX

Variables	Coefficient	Std Error	Beta t-values	Sig.
Constant	0.270	0.025	10.710	0.000
FINP	0.000	0.004	0.032	0.975
BSIZE	0.004	0.009	0.443	0.659
INTAUD	0.013	0.011	1.247	0.216
EXTAUD	0.047	0.013	0.399	0.001*
ORGSIZE	0.006	0.004	1.303	0.197

\* significant at 1% level

The most significant variable in GI disclosure index is the existence of the external auditor. The result supports numerous previous empirical studies that the organizations disclose more information once they established the independent party, such as the external auditor. The external auditor acts as a tool for quality reporting [28]. It is suggested that external auditors play a major role in governing disclosure practices.

## VI. DISCUSSIONS AND CONCLUSIONS

This study reports the results of an empirical study in which the impact of financial performance, board size, existence of an internal and external audit, and the organizational size on the extent of RNPOs disclosure practices. In addition, low disclosure levels were found in the sample under study. The extent of disclosure was investigated by employing partial disclosure indexes of BI disclosure index, FI disclosure index and GI disclosure index. The results of multiple regression analysis indicate that each organizational attribute has a different impact on each of the partial disclosure indexes. While board size was positively significant at the 0.01 level for both BI and FI disclosure indexes, the organizational size

was not significant across all PDI. As expected, the establishment of an external audit was also significant with the GI disclosure index. On the extreme, organizational size and the existence of an internal audit were not significant to any partial disclosure index. The results suggest that the regulators of RNPOs reporting should focus more on the size of board members and the existence of an external audit to ensure adequate supply of information disclosed in the annual returns of RNPOs.

Future research may also benefit by considering a few elements. First, developing specific disclosure index also might prove useful for RNPOs. This could provide additional insight into RNPOs disclosure practices of which was not eligible for tax-exempt status application in Malaysia. Also, applying the disclosure index to several years of annual returns, rather than a single year, might provide useful contribution into how an individual RNPO's disclosure practices vary over time. Secondly, consider additional variables such as government involvement, fiscal performance ratio or age of the organization might enhance the explanatory power of the existing variables. Finally, future research may also benefit by considering the difference between the ownership structure (regulatory formation) of RNPOs with the disclosure practices. However, availability of data appears to make such a study possible.

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