

# Financial Management Challenges Faced by Islamic NGOs in Malaysia

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## Abstract

Non-governmental organizations (NGOs) play an important role in carrying out aid missions to the community at the national and international levels. However, the reputation of these organizations is somewhat affected, especially when financial management scandals begin to emerge, particularly involving Islamic NGOs. This issue is a source of displeasure and concern, especially among donors and agencies that provide assistance to these NGOs. Failure to be transparent when providing information results in donors feeling less confident in the NGO's credibility and this leads to prospective or even current donors withdrawing from participating in philanthropic contributions. Therefore, this study aims to examine the financial management challenges faced by NGOs in Malaysia and also provide a comprehensive literature on challenges and previous studies related to financial management issues faced by NGOs. Findings indicate that the legitimacy, accountability and transparency, as well as accountability practices and governance are some of the challenges faced by Islamic NGOs in Malaysia when managing their own finances and public funds.

**Keywords:** Financial Management, Challenges, Non-Governmental Organizations (NGO)

## Introduction

The involvement of non-governmental organizations (NGOs) in the development of a country's capacity is not a new thing. NGOs play an important role as a medium for humanitarian aid and a platform for economic and socioeconomic development in a country. Since the early 1990s, there has been an exponential increase in the number of NGOs worldwide and in 2015 alone it was estimated that there were more than 10 million NGOs worldwide (Ariela, 2023). This increase is driven by the number of donors donating to NGOs that increased from 1.2 billion in 2011 to 1.4 billion in 2014 and by 2030, this number is expected to increase to 2.5 billion (AWSP, 2015). A similar development trend was also recorded in Malaysia. According to the Registrar of Societies (ROS), 1215 NGOs under the welfare and religious preaching NGO category were officially registered. These organizations are classified under "Religious-NGO" (Omar & Al-qudsy, 2016)

Non-profit organizations, especially those based on welfare and religion, have long played an important role in society, especially in Malaysia. However, this institution is tainted with scandals of inefficient management and misuse of funds involving the accountability and

governance of the organization. However, there is a lack of discussion and research on this issue and there is still no legislation or guideline that can be used to deal with this problem. Many previous studies have focused on the history and development of NGOs in Malaysia (Abd Ghani & Ishak, 2021; Soh & Tumin et al., 2017; Tumin & Nurhadi 2007). In addition, these studies have also discussed the function of NGOs in the field of welfare and society (Malik et al., 2018; Hassan & Rahman, 2012), preaching and social development (Puat & Abdullah, 2018), the environment and disaster risk reduction (Kassim & Taib 2015; Izumi & Shaw, 2012) as well as Islam, human and women's rights (Whiting, 2003; Steiner, 2019; Van Tujil, 1999). However, governance and transparency issues concerning Malaysian NGOs, especially religious and welfare-based NGOs, is presumably a new topic and has received less attention from the government and the general public.

Until recently, the transparency of NGO activists in relation to matters pertaining to the management of expenses and utilisation of funds sourced from public donations that are entrusted for the benefit of targeted recipients has been hotly debated. However, there are some segments of society that have misused these funds by taking advantage and hiding behind the original purpose of establishing these NGOs, which is to carry out humanitarian and welfare activities, but at the same time having the intention to seek personal profits and benefits. Hence, this study aims to discuss the financial management challenges faced by Islamic NGOs in Malaysia and also identify factors that influence the deluge of funds and financial mismanagement in Malaysian NGOs.

### **Legitimising NGOs**

The main factor that poses a challenge for managing Islamic NGO in Malaysia is the legitimacy and registration of NGO organizations. Apandi & Ali (2016) stated that the main aspect that threatens the credibility of NGOs in Malaysia is their legitimacy from an institutional aspect. This aspect is closely related to the NGO's registration as an organization registered with the government. In general, NGOs need to register their respective organizations with the Registrar of Societies Malaysia in accordance with the Societies Act 1966. Non-profit organizations or non-governmental organizations (NGOs) in Malaysia can be registered through two controlling bodies, namely the Companies Commission of Malaysia (CCM) or the Registrar of Societies (ROS). NGOs registered under SSM are subject to the Companies Act 1965 while NGOs registered under ROS are subject to the Societies Act 1966.

The registration process involves submitting various documents and information to the ROS, including the organization's constitution, a list of its office bearers, and details of its activities and objectives. The ROS will then review the application and decide whether to approve or reject the registration. Once registered, NGOs are required to comply with the Societies Act 1966, which outlines the rules and regulations that govern the operation of registered societies in Malaysia. These rules cover a wide range of areas, including membership, elections, finances, and governance.

Failure to comply with these rules and regulations can result in the suspension or revocation of the NGO's registration, which can have serious consequences for its ability to operate effectively. For example, NGOs that are not registered or have had their registration revoked may not be able to open bank accounts or obtain funding from certain sources. However, not all NGOs are registered with the Registrar of Societies. For example, most advocacy-oriented NGOs choose to be registered with the Department of the Registrar of Societies but as a

business entity or trust fund. Most NGOs prefer to be registered as a business company, not as an organization, due to the long registration process and/or the possibility of the registration as an organization being rejected by the Registrar of Societies as an NGO labelled as a threat to the government (Weiss, 2003). This creates confusion about the identity and reporting system that should be adhered to by NGOs. In summary, the legitimacy and registration of NGOs in Malaysia is a crucial aspect that affects their credibility and ability to operate effectively. It is important for NGOs to comply with the rules and regulations set out by the government in order to maintain their registration and legitimacy as an organization.

### **Transparency and Accountability**

The next challenge faced by Islamic NGOs is the transparency and accountability factor faced by the management when managing the collection and distribution of funds to the target group. There is no standard operating procedure (SOP) in Malaysia for NGOs for systematically managing the collection and distribution of funds. Many of the NGOs still do not have a standard operating procedure (SOP) for administration and financial management purposes, mainly those related to the remuneration system, employee rights, procurement procedures fund expenses and financial reports.

Accountability is closely related to the management of an organization, especially NGOs that manage funds sourced from public donations. Accountability from an accounting perspective refers to "*the need or responsibility to provide an account (not necessarily a financial account) or a financial ledger for further action by the responsible parties*". Accountability is divided into three types, namely fiscal accountability, process accountability and program accountability. Fiscal accountability compares the use of resources with the established benchmarks, while the second type of accountability is related to the use of certain processes for implementing an activity (Ramli & Shuib, 2020).

According to Zakari (2013), accountability, from the perspective of charitable bodies and non-profit organizations, can be divided into three types, namely upward, downward and holistic accountability. Upward accountability is basically accountability to donors, sponsors and bodies that regulate NGO operations. According to Christensen and Ebrahim (2006), downward accountability, which refers accountability to beneficiaries, does not receive much attention and is usually marginalised. This kind of accountability is less practiced by institutions and depends more on the party's sense of responsibility (Christensen & Ebrahim, 2006).

Nahan (2003) found that the majority of non-profit organizations in Malaysia are still in a lacklustre state, when it comes to implementing accountability. An inefficient information delivery method and frequent political interference are some of the reasons responsible for the lacklustre management of NGOs in Malaysia. This is because a strong sense of accountability requires transformation initiated by various elements, including leadership, culture, organizational structure and, employees in particular. Harun (2021) used the literature review method to study the level of downward transparency in Malaysian-Palestinian NGOs in this country. The study found that the NGO's top management needs to increase the level of accountability and fully enforce upward and downward accountability in an efficient and effective manner.

In addition to accountability, the transparency concept is also a challenge to a Malaysian NGO's financial management. Following the escalation in cases of fraud and misappropriation, the public, especially donors, are becoming more cautious and demand that NGOs provide transparent and detailed information regarding fundraising activities and distribution of funds. Most Islamic NGOs in Malaysia still refuse to disclose information, especially regarding financial aspects compared to non-financial aspects. This seems to affect the confidence of donors and contributors. Islamic NGOs in Malaysia should use a systematic and transparent reporting framework to gain the confidence of public donors. Other factors, such as incomplete record keeping, as well as irregular and unsystematic financial monitoring, can affect the administration and effectiveness of an NGO's function (MAPIM, 2022).

### **Self-Evaluation**

The next aspect that can have a positive impact on the credibility of an NGO in Malaysia is the issue of self-evaluation. As highlighted by Weiss (2003), the most glaring weakness of NGOs in Malaysia is critical self-evaluation, sustainable long-term planning and long-term survival of an NGO. A critical self-evaluation is important for ensuring the NGO's credibility and the achievement of its original function. In fact, critical self-evaluation also enables NGOs to practice good governance.

The systematic evaluation and reporting aspect enable NGOs to protect themselves from being misused and abused, especially by its own members and the management. This is important to ensure that everyone in the NGO is bound and complies with the stipulated procedures and obeys the NGO's constitution. Meanwhile, determining the agenda and planning aspects ensure the NGO's credibility as a platform for the people's voice and not to be influenced by the founders, donors or a small faction in the NGO. Conversely, the auditing aspect allows the NGO to ensure that funds donated by various donors are used for the NGO's activities to help the community in accordance with the objective of the NGO's establishment.

The financial statements of NGOs registered under CCM are required to comply with the Malaysian Financial Reporting Standards (MFRS) issued by the Malaysian Accounting Standard Board (MASB) and must be audited on par with other private entities. However, for NGOs registered under ROS, they are only encouraged to comply with MFRS and they are not obliged to audit their financial statements, although this can be done voluntarily. Moreover, according to Section 14(d) of the Societies Act 1966 (Act 335) and the Regulation Act 1984, organizations are required to submit an annual return (Form 9) together with a Statement of Receipts and Payments and a year-end financial balance sheet within 60 days after the annual general meeting. Nevertheless, cash flow statements, statement of changes in general funds, notes on significant accounting policies and other additional statements do not need to be submitted.

The transparency in an NGO's auditing can also be regulated by sharing audit findings and reports on the NGO's official website to enable easy access by the public. All these aspects are important elements that ensure a critical self-evaluation by the NGO and at the same time ensure the NGO's credibility in safeguarding the community's welfare and other target groups. This means that critical self-evaluation also enables NGOs to overcome other weaknesses, such as mismanagement, inefficient organizational governance and its long-term survival (Weiss, 2003).

**Governance**

The concept of governance is an important element that ensures the administration and financial management of an institution. Good governance practices are receiving greater attention, including from government and non-government institutions. Good governance is important for ensuring sound financial reporting and preventing fraud by irresponsible parties, especially concerning Islamic NGOs. This also helps in reducing the element of corruption and can instigate the involvement of opinions, voices and views of minorities or the public in the decision-making process (Nordin, 2022).

Nordin et al (2020) designed a Syariah-based governance model for use by Islamic NGOs in Malaysia, known as i-Governance, to strengthen global humanitarian missions. The i-Governance model consists of three main principles, namely Iman, Islam and Ihsan, which are pivoted on the Caliphate concept. Implementation of good governance starts with humans who is assigned to be the Caliph on this earth. Thus, by using the thematic analysis method, this study emphasized that Syariah compliance is a fundamental element in Syariah and thus, Syariah governance is the ideal approach to ensure compliance to good governance and further increase the level of efficiency and trust in Islamic NGO organizations in particular.

Generally, there are some Syariah governance rules or guidelines issued by several countries, such as Malaysia, or organisations, such as Accounting and Auditing Organization for Islamic Finance (AAOIFI and IFSB). However, these guidelines are not applicable to general organizations such as Islamic NGOs and there is no special standard that can be used by Islamic NGOs as Syariah governance rules or specific guiding principles for Islamic NGOs (Muneza & Hassan, 2014). It is therefore necessary to develop a uniform Syariah governance code for all Islamic organizations regardless of their importance, function or locality.

**Steps for Improving the Financial Management of NGOS**

Improving the financial management of NGOs requires a comprehensive approach that involves several steps. In order to ensure that the management of donations from the general public is transparent, well-managed and void of any element of corruption, there are several steps that can be taken to guarantee the credibility of NGOs. NGOs should prepare and present financial reports in a transparent manner in order to increase the credibility and confidence of donors that the donation has been successfully delivered to the target group. Although, reports have been made to the Department of the Registrar of Societies or better known as ROS, NGOs can take the initiative to make periodic reports on a monthly, half-yearly or annual basis to the public, as implemented by zakat institutions in Malaysia when reporting on tithe collections and distributions. A detailed report can be made comprising details such as the total amount of donations collected, amount of commission for administrative and management expenses, as well as the amount of donations channeled to eligible recipients or targets of humanitarian and welfare missions (Azri, 2021). Hence, to ensure transparency, information in the form of the NGO's financial management, fund management and fund collection expenses, are the basic information that the management must provide to the public in order to ensure and gain the confidence of donors.

Besides, NGOs should have clear policies and procedures that govern their financial management practices. These policies should cover all aspects of financial management, including budgeting, accounting, financial reporting, and internal controls. They should be

documented, communicated to all stakeholders, and reviewed periodically to ensure they remain relevant and effective. Clear financial policies and procedures are essential for effective financial management in NGOs. These policies provide a framework for financial decision-making and help to ensure compliance with legal and regulatory requirements. In addition, they help to promote transparency, accountability, and good governance. NGOs that have clear financial policies and procedures in place are more likely to be effective in achieving their objectives and attracting funding from donors and other stakeholders.

According to a study by the World Bank, NGOs that have clear financial policies and procedures in place are more likely to be effective in achieving their objectives, compared to those that do not have such policies (World Bank, 2012). In addition, NGOs with clear financial policies and procedures are more likely to attract funding from donors and other stakeholders.

Define Financial Management Responsibilities is also important since the roles and responsibilities related to financial management should be clearly defined and communicated to all relevant staff and stakeholders. This includes responsibilities for budgeting, accounting, financial reporting, and internal controls. In addition, establish budgeting Practices: NGOs should develop clear and realistic budgets that align with their organizational objectives. Budgets should be regularly monitored and reviewed to ensure that they remain relevant and effective.

Apart from that, accounting procedures should be established to ensure the accuracy and completeness of financial data. This includes procedures for recording financial transactions, reconciling accounts, and preparing financial statements. Besides, NGOs should develop clear and concise financial reporting practices that provide stakeholders with timely and accurate information. Financial reports should be prepared in accordance with relevant regulations and standards (Yusof et. al., 2017).

The other steps to improve financial management is to establish risk management practices. NGOs should develop risk management practices to identify, assess, and mitigate financial risks. This includes procedures for managing cash flow, investments, and foreign exchange risks. In addition, financial policies and procedures should be regularly reviewed and updated to ensure that they remain relevant and effective. This includes ensuring compliance with changing regulations and standards

The NGO also must implement effective internal controls. Internal controls are policies and procedures designed to ensure the accuracy and reliability of financial information, as well as to prevent fraud and misappropriation of funds. NGOs should have effective internal controls in place to safeguard their assets and ensure the integrity of their financial reporting. Internal controls should be implemented to prevent fraud, misappropriation of funds, and errors in financial reporting. This includes procedures for authorization, segregation of duties, and monitoring of financial transactions.

NGOs should also conduct regular audits of their financial statements to ensure that their financial management practices are compliant with relevant regulations and standards. Audits can also identify areas for improvement and help NGOs to develop strategies for



enhancing their financial management practices. Besides, NGOs should foster a culture of transparency and accountability by communicating openly with their stakeholders about their financial management practices. This includes providing regular financial reports and engaging in dialogue with donors, partners, and beneficiaries about the organization's financial performance. By implementing these steps, NGOs can improve their financial management practices and enhance their credibility and trustworthiness with donors, partners, and beneficiaries.

### **Conclusion**

The past few decades have seen Islamic NGOs playing an important role in the development of a society, including the religious, welfare, economic and social aspects. An Islamic NGO is not only actively involved in collecting donations to distribute to the target group, but they are also involved in repair works and relief missions, especially in times of an emergency or disaster. The operations of an Islamic NGO, whether at the international or national level, depends on the strength of its financial resources, as well as the ability and efficiency in managing its financial administration. This is because the majority of funds are sourced from donations and collections from the public. Islamic NGOs in Malaysia are made up of various backgrounds and have various functions and roles. The ability and reputation of an Islamic NGO is highly dependent on the trust and confidence that the public has on the particular NGO.

The NGO will be affected when there are weaknesses and failures in its management, especially in relation to financial management and administration. Failure to manage finances properly and transparently will lead to abuse of power or breach of trust and this will hinder the established agenda and objectives of the Islamic NGO. Therefore, this paper found that in ensuring the sustainability of financial management of Islamic NGOs, they need to emphasize the need for transparency, accountability, self-evaluation, and good governance, as well as adherence to established rules and policies. These factors are critical to maintaining the trust and confidence of the public and ensuring that the organization's objectives and agenda are achieved in the most effective way possible. Adherence to the rules and policies outlined is important to ensure that the Islamic NGO's objectives and agenda are implemented and at the same time benefit the organization and beneficiaries. In addition, this will also ensure the success of a project or aid mission and detect any deviation or misuse of donations or aid by irresponsible parties. This will ensure the long-term sustainability of the organization as well as the achievement and maximization of the NGO's objectives and agenda, as best as possible.

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