

The Influence of Board of Directors' Characteristics and Internal Audit Practices on the Financial Sustainability of Incorporated Waqf Institutions (IWIS) in Malaysia

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Abstract

Financial sustainability is a crucial factor in ensuring the long-term viability of waqf institutions, particularly in Malaysia, where these institutions contribute significantly to social welfare and poverty alleviation. Governance plays a fundamental role in this sustainability, with Board of Directors (BOD) characteristics and internal audit practices influencing operational efficiency and accountability. This conceptual study examines the impact of key BOD attributes such as CEO duality, BOD independence, size, diversity, and educational background on the financial sustainability of Incorporated Waqf Institutions (IWIs). The study further investigates whether the presence of an internal audit department moderates this relationship. Drawing on content analysis and panel data extracted from audited financial reports. Data are then analysed quantitatively using regression analysis based on the Tuckman and Chang model. The findings are expected to provide empirical insights into governance mechanisms that support financial performance in structures in IWIs. Additionally, the findings offer practical recommendations for policymakers, regulators, and waqf administrators to enhance governance, accountability and donor trust.

Keywords: Waqf Institutions, Financial Sustainability, Governance, Board of Directors, Internal Audit

Introduction

The 2030 Agenda for Sustainable Development Goals (SDG) adopted by the United Nations (UN) members listed 17 SDG that the members are planning to achieve by the year 2030. Among the 17 SDG that UN wants to achieve are SDG Number 1 No poverty, SDG Number 2 Zero hunger, SDG Number 3 Good health and wellbeing and SDG Number 4 Quality education.

In Malaysia, the assistance from Government to achieve these four goals these four goals becoming limited due to increasing budget deficit. For example, in the 2023 World Bank's

report highlighted that Malaysian government spending on educations was reducing from the year 2020 to 2022 (World bank, 2023). Thus, it becomes the responsibility of the non-profit organizations to fulfill this role. Waqf institution is considered as a non-profit organization. The institution can help in achieving the four SDG goals as stated above. In achieving this objective, the financial sustainability of these institutions becomes a very important factor.

A simple definition of waqf is an endowment or donation made by a Muslim to a religious, educational, or charitable cause. According to Malaysian law, waqf is defined as any property being moveable or immovable from which usufruct or benefit may be used for any charitable purpose (Syed & Mohamed, 2014). History has proven that waqf in its glory days can be used to help the needy to ease their economic hardship by providing assistance such as food, education and monetary benefits. As documented, Waqf was highly utilized for socioeconomic development and specifically for poverty eradication during the Ottoman Empire (Ibrahim & Mohamed Isa, 2021). At that time in Turkey, waqf was used to build houses, inns, orchards, and agricultural activities. Waqf has benefited 30,000 people (Senkaya, 2012).

Historically, waqf has seen its glorious days during Ottoman empire (Ibrahim & Mohamed Isa, 2021). Currently, many waqf institutions struggle with financial sustainability due to irregular donor contributions and insufficient revenue streams. Approximately 87% of waqf land in Malaysia remains underdeveloped, significantly limiting its ability to generate income and fulfil its charitable purposes (Kamarudin, 2019; Berita RTM, 2023). Additionally, fragmented governance structures, political interference, and transparency issues further exacerbate inefficiencies in waqf management (Md Hussain et al., 2021; Kamaruddin & Hanefah, 2021). While federal initiatives such as Jabatan Wakaf, Zakat dan Haji (JAWHAR) and Yayasan Waqf Malaysia (YWM) aim to improve waqf administration, inconsistencies persist due to variations in management frameworks among State Islamic Religious Councils (SIRCs) (Ahmad Ayedh et al., 2019).

Governance challenges remain a major obstacle to financial sustainability. Issues such as political appointees obstructing institutional decision-making, limited financial disclosures, and a lack of qualified management personnel have been widely documented (Aqil, 2019; Hassan et al., 2022). The absence of internal audit mechanisms further erodes financial accountability, restricting donor trust and stakeholder engagement (Md Zain, 2005; Shariff & Fadhila, 2023; Harris & Neely, 2021). These issues will affect the financial sustainability of the institutions if remain unaddressed as limited funds available will impede the waqf institutions in fulfilling the objectives of the institutions as well as the wishes of the donors. Improvement in governance will mitigate the administrative issues in these institutions and ensure waqf institutions are able to accomplish the full potential continuing its success like of waqf institutions during Ottoman empire.

Research Background and Literature Review

The sustainability of waqf institutions has been an essential component of Islamic economic development for centuries, particularly in providing financial stability for religious, educational, and social causes. Historically, waqf institutions played a fundamental role in poverty alleviation and socio-economic advancement, notably during the Ottoman Empire, where they were instrumental in supporting housing, healthcare, and education (Ibrahim &

Mohamed Isa, 2021). However, as waqf institutions evolved, they increasingly faced challenges related to financial sustainability, governance inefficiencies, and transparency in reporting.

Financial sustainability is a key determinant of waqf institutions' ability to continuously fulfil their intended missions. In a profit-based organization, financial sustainability is often assessed through profitability metrics. However, non-profit organizations, including waqf institutions, rely on donor contributions and asset management to sustain operations its operations (Chiko-Schultz & Neely, 2016). The financial sustainability of waqf institutions is an issue upon facing with crisis such as Covid-19 pandemic (Ibrahim et al., 2024). The effectiveness of governance mechanisms, particularly board oversight and audit practice, plays a vital role in ensuring funds are managed responsibly while maximizing long-term financial stability.

Governance and Financial Sustainability in Nonprofit Organizations

Corporate governance research has extensively analysed the role of Board of Directors (BOD) characteristics in influencing financial performance and sustainability (Harris & Neely, 2021). In profit-oriented firms, attributes such as Chief Executive Officer (CEO) duality, board independence, board size, gender diversity, and educational background have been found to improve operational decision-making and financial resilience (Khamar Tazilah et al., 2021; Al Matari, 2020). The application of these governance principles to nonprofit organizations, particularly waqf institutions, remains relatively underexplored, despite their comparable need for financial stability and strategic oversight (Ihsan & Ibrahim, 2007).

CEO duality, where the CEO also assumes the role of board chairman, has sparked ongoing debate regarding its impact on organizational performance. Proponents argue that combined leadership ensures strategic alignment and efficiency, while critics highlight potential agency conflicts and weaker accountability structures (Haddad, 2022). Similarly, board independence, defined by the presence of non-executive directors, is frequently associated with enhanced governance and transparency, as external members provide objective oversight (Haifawi et al., 2022). In waqf institutions, independent directors can play a crucial role in ensuring that donations are utilized as per donors' intentions while mitigating risks associated with political interference (Md Hussain et al., 2021).

Another critical factor influencing financial sustainability is board size. While larger boards provide diverse perspectives and expertise, excessively large boards may lead to communication inefficiencies and slow decision-making processes (Al Matari, 2020; Khurshid et al., 2019). On the other hand, gender diversity within boards has been increasingly recognized for fostering balanced leadership approaches and reducing managerial opportunism (Zhou, 2019). Studies suggest that female directors contribute to more effective risk management and financial oversight, particularly in nonprofit entities reliant on donor trust (Ntim et al., 2017).

Finally, educational background plays a vital role in determining board effectiveness. Directors with expertise in finance and accounting are better equipped to assess an institution's financial health and contribute to strategic decision-making (Zalata et al., 2022). Given the intricate financial structures governing waqf institutions, matters on asset

development, endowment management, and public accountability, having financially literate board members could significantly enhance financial sustainability (Md. Zain, 2005).

Internal Audit as a Moderating Factor

In addition to board governance, internal audit practices are a critical element of financial oversight. A well-functioning internal audit department strengthens financial sustainability by ensuring compliance with financial regulations, monitoring fund allocations, and mitigating risks of mismanagement (Alsurayyi & Alsughayer, 2021). Previous studies on profit organizations suggest that internal audit moderates the effectiveness of governance structures in enhancing firm performance (Ganesan et al., 2018; Al-Matari & Hussein, 2019). However, little research has been conducted to assess the moderating role of internal audit in nonprofit waqf institutions.

Moreover, governance weaknesses in waqf institutions, such as delayed decision-making processes, lack of financial reporting transparency, and political influence, have been linked to inefficiencies in asset development and financial sustainability (Kamaruddin & Hanefah, 2021). In Malaysia, financial sustainability remains a concern as nearly 87% of waqf lands remain underdeveloped due to funding limitations and governance challenges (Kamarudin, 2019; Berita RTM, 2023). The presence of an internal audit department could strengthen waqf institutions' ability to sustain operations, improve financial reporting integrity, and foster donor confidence.

Problem Statement

Waqf institutions in Malaysia are vital non-profit entities that contribute to social welfare by funding education, healthcare, and poverty alleviation. However, these institutions face serious challenges in achieving financial sustainability. Unlike profit-oriented organizations that generate income through business operations, waqf institutions depend heavily on voluntary donations, which are often irregular and insufficient -particularly during times of crisis such as the COVID-19 pandemic (Linh & Anh, 2020; Ab Samad & Ahmad, 2021; Ibrahim et al., 2024). This reliance on unstable funding has resulted in underutilization of waqf assets, with studies indicating that up to 87% of waqf land in Malaysia remains undeveloped due to a lack of capital and investment partners (Kamarudin, 2019; Md Hussain et al., 2021).

In addition to financial issues, governance weaknesses hinder the effective management of waqf institutions. The current decentralized system, governed by State Islamic Religious Councils (SIRCs), has resulted in inconsistent practices across states. Delays in decision-making, political interference, and the lack of professional board members have obstructed development projects and compromised operational efficiency (Md Hussain et al., 2021; Aqil, 2019). Furthermore, most waqf managers come from religious backgrounds and often lack the necessary skills in finance and administration to manage these institutions effectively (Sukmana, Ratnasari & Widiastuti, 2022).

Transparency and accountability also remain major concerns in non-profit organizations (Ibrahim et al. 2023). Many waqf institutions fail to publish timely and audited financial reports, making it difficult for donors and stakeholders to assess their performance or ensure that funds are being used as intended (Ahmad Ayedh et al., 2019; Shariff & Fadhila, 2023). This lack of disclosure has weakened public trust and reduced donation levels, further

threatening the institutions' sustainability (Harris & Neely, 2021; Abdul Shukor et al., 2019). Addressing these financial and governance issues through improved oversight, internal auditing, and professional management is critical to ensure that waqf institutions can continue to fulfil their intended social and religious roles.

Research Gap and Contribution

While studies have assessed the financial performance of waqf institutions (Sulaiman & Zakari, 2019; Kamarudin & Hanefah, 2021), limited empirical evidence exists regarding how specific board characteristics influence financial sustainability in these institutions. Furthermore, the role of internal audit as a moderating factor between governance characteristics and financial sustainability remains unexplored. This study aims to fill these gaps by applying financial and governance models to waqf institutions and empirically assessing their financial sustainability over a number of years.

By examining the interplay between board governance and financial sustainability, as well as the moderating role of internal audit, this study provides new insights into improving governance mechanisms for waqf institutions. Findings will offer recommendations for policymakers, regulators, and waqf administrators, promoting better financial strategies for sustaining waqf assets and ensuring their long-term viability.

This study investigates how Board of Directors (BOD) characteristics; including CEO duality, independence, size, diversity, and educational background affect financial sustainability in incorporated waqf institutions, and whether the presence of an internal audit department moderates these relationships. Findings from this study will provide actionable insights for policymakers and waqf administrators to strengthen waqf governance and enhance its long-term sustainability.

Research Objectives and Questions

The research paper seeks to achieve its general objective to identify the effect of BOD Characteristics towards financial sustainability of states managed incorporated waqf institutions (IWIs) and the IWIs' internal audit (process or department). In addition, the research objective would like to find out whether having an internal audit influence the IWIs' financial sustainability by itself as well moderating the relationship between BOD Characteristics and financial sustainability of IWIs. The research research questions and objectives are illustrated as per table in the next page.

Table 1.1
Research Questions and Objectives

Research Questions (RQ)	Research Objectives (RO)
RQ1 – Do BOD characteristics influence the financial sustainability of IWIs?	RO1 - To examine the influence of BOD characteristics covering CEO duality, BOD independent, BOD size, BOD diversity and BOD educational background on IWI’s financial sustainability.
RQ2 – Do BOD Characteristics influence the presence of internal audit in IWIs?	RO2 - To assess the influence of BOD characteristics on the presence of internal audit functions in IWIs.
RQ3 – Does internal audit affect the financial sustainability of IWIs?	RO3 - To evaluate the impact of internal audit on IWI’s financial sustainability.
RQ3 - Does internal audit moderate the relationship between BOD characteristics and financial sustainability of IWIs?	RO3 - To investigate whether internal audit moderates the relationship between BOD characteristics and IWI’s financial sustainability

Methodology

This study adopts a quantitative design using panel data analysis to evaluate the impact of BOD characteristics and internal audit on financial sustainability of incorporated waqf institutions (IWIs) in Malaysia.

Data Collection

The population for this study comprises all eight incorporated waqf institutions in Malaysia. The primary sources of data include audited annual financial reports, corporate governance disclosures, and institutional websites. These documents provide both financial metrics and board-related governance indicators essential for the study.

Variables and Measurement

The dependent variable is financial sustainability, operationalized using the Tuckman and Chang (1991) model. This model incorporates four key ratios: equity balance, revenue concentration, administrative cost ratio, and operating margin. The independent variables consist of board characteristics, namely CEO duality, BOD independence, size, gender diversity, and directors’ educational background. Additionally, the study introduces the presence of an internal audit department as a moderating variable, hypothesizing that it may strengthen or weaken the relationship between board characteristics and financial sustainability.

Data Analysis Procedures

The analysis will proceed in four main stages. First, descriptive statistics will be used to assess trends in financial sustainability across the sample and over time. Second, Pearson correlation analysis will be employed to explore the linear relationships between the variables. Third,

panel data regression analysis (fixed or random effects models based on Hausman test results) will be conducted to determine the impact of board governance characteristics on financial sustainability. Finally, hypothesis testing will be carried out to examine the statistical significance of the relationships and to evaluate the moderating effect of internal audit presence on the identified relationships.

This methodological framework ensures a robust examination of how governance mechanisms influence the financial sustainability of waqf institutions and offers empirical insights into improving governance practices in the non-profit Islamic sector.

Significance of the Study

The financial sustainability and governance practices of waqf institutions in Malaysia have emerged as critical areas of concern, especially in the face of growing socioeconomic demands. As religious-based non-profit organizations, waqf institutions rely primarily on voluntary contributions and are expected to fulfil charitable objectives such as poverty alleviation, education, and healthcare. However, previous studies have shown that many of these institutions struggle with financial instability and ineffective governance structures (Ab Samad & Ahmad, 2021; Sulaiman & Zakari, 2019).

This study aims to assess the financial sustainability of Incorporated Waqf Institutions (IWIs) in Malaysia using descriptive financial measurements. The findings will provide a clear picture of each IWI's financial health and identify areas for improvement. The resulting data can be used by IWI's BOD and senior management to implement corrective strategies to enhance institutional performance, which in turn can benefit the local communities these institutions are intended to support (Kamarudin, 2019).

Furthermore, the study explores the potential role of governance mechanisms in improving Waqf administration. It advocates for the incorporation of all state Waqf institutions to standardize management practices and strengthen internal controls. Incorporated entities are generally subject to regulatory frameworks such as the Malaysian Code of Corporate Governance (MCCG 2021), which promotes transparency, accountability, and efficient board oversight (Suruhanjaya Sekuriti Malaysia, 2021). The findings from this study will become a push factor to those who is in charge of governance in waqf institutions in establishing an internal audit department and inculcate qualified board structures. Application of these principles can significantly reduce future mismanagement.

Transparency and accountability are additional benefits of incorporation. Incorporated IWIs are mandated to prepare audited annual financial reports, increasing donor confidence and public trust. These reports, when published online, allow donors and stakeholders to monitor how their contributions are managed, thus reinforcing accountability (Ahmad Ayedh et al., 2019). Enhanced transparency is likely to attract more donors and secure a stable flow of contributions, which is essential for long-term sustainability (Harris & Neely, 2021). In addition, the benefits obtain from published audited annual reports will act as a catalyst to policy makers to strengthen regulation for non-profit organisations disclosure.

Finally, the study proposes the establishment of a central waqf holding company to consolidate funds and resources of all the incorporated waqf institutions. Such an entity could

strategically manage undeveloped waqf assets and mobilize large-scale development projects, thereby maximizing waqf land utilization and institutional impact. This centralized model offers a practical solution to overcoming the inefficiencies currently observed across the fragmented state-managed waqf institutions (Mohd Hanefah et al., 2020).

Conclusion

This study seeks to address the critical challenges of financial sustainability and governance within states managed incorporated waqf institutions (IWIs). Drawing on a quantitative framework, it examines how board characteristics, such as CEO duality, independence, size, diversity, and educational background, affect financial sustainability, while also exploring the moderating role of internal audit functions. The study is grounded in panel data collected from audited financial reports, offering a comprehensive and longitudinal view of institutional performance.

Given the increasing reliance on waqf institutions to deliver social and economic benefits in the face of limited public funding, enhancing their financial sustainability is essential. This research will contribute to existing literature by offering empirical evidence on governance practices specific to religious non-profit organizations, an area that remains underexplored. The findings are expected to provide actionable insights for policymakers, regulators, and waqf administrators on the implementation of governance reforms that foster transparency, accountability, and long-term viability.

Ultimately, this study aspires to support the transformation of waqf institutions into more resilient and impactful entities. By aligning governance structures with sound financial management, waqf institutions can better fulfil their mission, regain public trust, and play a more effective role in achieving broader national and global development goals.

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