Governance Framework for Philanthropic Organisations Directed Towards Taqyid al-Mutlaq

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ABSTRACT
Philanthropic organisations (POs) have grown substantially in numbers and size, indicating significant role towards the advancement of society. Concurrently, there are also increasing adverse publicity surrounding a number of high profile scandals of fund misappropriation and organisational inefficiency in these organisations. In mitigating these issues or to achieve taqyid al-mutlaq, there is a need to strengthen the governance of these organisations. Good governance allows POs to manage their risks more effectively, build public trusts, legitimacy and long term survivability. Hence, this study aims to examine the types and extent of governance practices of POs in Malaysia. In achieving these objectives, this study developed a governance framework system that allows regulators, POs or other relevant stakeholders to assess the types and extent of governance practices. The governance practices are based on four themes: strategic, procedural, fiduciary and financial. The data used in this system is based on POs registered with Companies Commission of Malaysia. The system contributes the following benefits to the regulators: profiling of the POs based on the extent of their governance practices, systematic monitoring based on the profiles and capability building in enhancing their good governance practices. Concurrently, the individual PO can also focuses on areas of governance framework that could be developed further to achieve best practice. Overall, this study fills the gap in the literature on the governance of POs and in practice, the proposed good governance framework system can facilitate practical implementation of taqyid al-mutlaq in enhancing the philanthropy sector. Future research may extend the framework to disclosures of good governance practices for the POs. More transparent good governance practices encourage trusts within, and of, an organisation.

Keywords: Governance, Taqyid al-Mutlaq, Philanthropic Organisations

1. INTRODUCTION
Solving social issues such as homelessness, youth unemployment, reoffending prisoners and drug abuse are crucial in enhancing the socio-economic development of any countries. Resolving these issues has traditionally been the responsibility of the government and consumed a large amount of public expenditures. Despite various initiatives by the government, some sections of society remain vulnerable. The single handed approach by the government, coupled with the current challenging economic environment, reduces the availability of funds and sustainable provision of social services. In this context, the philanthropic organisations (POs) have always been facilitating the government in resolving various social issues. POs are generally referred to as charitable and voluntary organisations established to carry out social mission for the betterment of the society. Their substantial growth in numbers and size indicate significant role towards the advancement of society. They are funded through donations, grants and other resources from various contributors. In this paper, the terms philanthropic organisations, social organisations, non-profit organisations and charitable organisations will be used interchangeably.

A growing number of literatures on charitable organisations highlighted the issues surrounding the widely accepted assumptions that these organisations pursue their missions selflessly, effectively and efficiently (e.g Connolly and Hyndman, 2013, Dellaportas et al, 2011). There are increasing
concerns with regards to the rising sophistication of fraud or financial crimes committed by the charitable organizations around the world. For example, an estimates of more than USD 40 billion of POs funds are misused or misapplied for personal enrichment rather than charitable work within the US each year (ACFE Reports from 2010 to 2014 / Janet Greenlee (2007)\(^1\)). At the same time, the number of charitable organisations being penalized for regulatory and sanctions violations in the U.S., the UK, the European Union and elsewhere has increased in recent years. In Malaysia, although there is no official data released by the authority on the financial crime involving charitable organisations, it is believed that the sector also do not miss out on this issue. Misappropriation of tsunami fund in 2006 estimated around RM9.82 million to RM4 millions of unrecovered fund due to investment in bogus company are among the cases that tarnished the image of the Malaysian charitable sector. These fraudulent cases have given rise to various concerns regarding the need for good governance and transparency in the sector. In addition to these issues, the charitable sector is also facing increased competition in attracting private and public funds due to the current economic environment. In addressing the funding issues, many POs are also engaged in a diverse range of revenue-generating activities. Needless to say, these activities raise additional concerns when POs claim to exist for the public benefit but engage in commercial activities.

In addressing the funding issues for POs, the potential of the Islamic social funds, such as Qard (interest-free loans), forbearance, Zakah (obligatory religious charity), Awqaf (voluntary and organised religious charity), and Sadaqat (unorganised and voluntary religious charity) to fill the funding gap in resolving social issues is huge. In optimizing the delivery of social goods and services, there is a need for a systematic and collaborative approach between the government, private organisations and POs. The conventional approach where the private organisations are contributing to the social issues through their corporate social responsibilities and the POs through their social missions, does not provide a platform to systematically address the social issues resulting in sections of society remaining vulnerable. The collaborative approach can tap into the strengths of the government, the private sector, and the social sector to address social disparities. The government and the private sector can align their resources to support the social sector to come up with creative and effective interventions on social issues. An important foundation in forming a successful and sustainable partnership between the three sectors is trust. In particular, the providers of resources, the government and the private organisations, require some information to assess that the resources provided are efficiently and effectively managed by the social organisations in delivering the social output to the beneficiaries. In building greater trusts, a large body of literature on effectiveness in the social sector propose the importance of managing and communicating good governance practices by the social organisations. Good governance extends beyond board composition, where it also integrates elements such as transparency, strategic management and risks management practices. Hence, there is a need to develop a framework on good governance to guide and support the social organisations in managing and communicating their governance more effectively and in doing so build greater trust, more effective delivery of social services and maximization of impact to the targeted beneficiaries. In line with this, the first objective of this paper is to propose a governance framework model incorporating antecedents and consequence of good governance. The second and more substantial objective is to develop a governance framework system that allows regulators, POs or other relevant stakeholders to assess the types and extent of governance practices. The proposed governance framework model makes two contributions. First, the model provides a framework for

\(^1\)The estimate of $40.24 billion is reached by multiplying the amount U.S. nonprofits contributed to U.S. GDP in 2010 ($804.8 billion) by the percentage of revenue that was estimated to be lost to occupational fraud in ACFE Reports from 2010 to 2014 (5%): Janet Greenlee et al., An Investigation of Fraud in Nonprofits Organizations: Occurrences and Deterrents, 36 Nonprofits& Voluntary Sector Q. 676, 677 (2007) (estimating that fraud loss to the nonprofits sector in 2004 was $40 billion).
future research. Second, the assessment system provides a practical contribution directed towards Taqyid al-Mutlaq and enhancement of socio-economic values to the Ummah.

The paper is organized as follows. In the first section of this paper, the social public-private partnership initiative in Malaysia is presented. In the second section, we review the literature in order to clarify accountability and good governance in the social sector. Next, focusing on antecedents and consequence of good governance, we develop and discuss propositions related to the accountability, shariah review and risks management practice. In the last section, we present a discussion of our proposition.

1.1 Social private and public partnership (SPPP) in Malaysia
SPPP initiative is a partnership programme between the government, private and social sectors to create innovative solutions for social issues. Social purpose organisations include POs, social enterprises, social non-government organisations and community-based organisations. This is illustrated in Diagram 1 below.

![Diagram 1: Overview of Social Public-Private Partnership in Malaysia](image)

In SPPP, the government and the private sector will be aligning their resources to support the social sector in coming up with a creative and effective interventions on social issues. In getting the grant, the SPOs must first show that they are reliable and capable of managing the grants and the relevant activities effectively and efficiently. Therefore, it is crucial that the SPOs are able to demonstrate their accountability in managing the funds and delivering their social goods. The accountability will be an important interface in the successful implementation of this initiative as illustrated in Diagram 2 below.
Diagram 2: Flowchart of social public-private partnership program in Malaysia

In the above model, there are three main groups of stakeholders: (i) social organisations, (ii) private organisations as investors and (iii) government and associated organisations as matching fund providers.

The above SPPP model is in line with the impact investing concept. This concept promotes investors to invest in social programmes with measurable social and financial returns. In many developed countries, this concept is further refined to incorporate evidence-based performance as a basis for the governments and associated institutions to make payments to the amount initially provided by the investors to the social programmes. The advantages of this concept are: (i) it brings financial capital to the social organisations to run their social programmes, (ii) it transfers the risks of the social programmes from the governments and associated institutions to the investors and the social organisations and (iii) it provides motivations for the social organisations to optimise their capabilities in delivering sustainable and measurable social outputs from their social programmes.

The SPPP model adopted in the above diagram is the first social PPP model introduced by the AIM in Malaysia under the Government Transformation Programme and National Blue Ocean Strategy initiatives in finding innovative approaches in delivering high impact, low cost, and rapidly executed public services to the society. Hence, the model adopted has some differences relative to the more matured implementation of the impact investing concept. The phases involved in implementing the SPPP model in Malaysia are as follows:

i. It starts with the social organisations identifying the social intervention programmes that can bring measurable social outcomes,

ii. This is followed by the social organisations securing funds from the private organisations or investors to run the social intervention programmes, and
iii. The social organisations will then proceed to the acquisition of matching fund stage from the
governments and associated institutions. Unlike the more matured PPP model, this phase is
where the governments and associated institutions make payment to the amount initially
provided by the investors based on measurable improved social outcomes of social projects that
lead to tangible public financial savings (such as less crime and increase in youth employment).

There are two key factors in enhancing the probability of successful implementation of the above
model. First, the availability of funds and second is the measurement of social outcomes. In Malaysia,
the funding gap for social programmes can be fulfilled through Islamic social financing. Such
financing has been acknowledged as part of the blue ocean strategy in Malaysia. In this context, the
introduction of the SPPP model is timely as it provides an innovative platform for Islamic social
financing to be utilised effectively and efficiently. Second, the social organizations must be able to
communicate that they are able to deliver the social objectives effectively and efficiently. The
information reported will facilitate the private organizations or investors and the government or
associate organizations to assess and monitor the performance of the social investors. More
importantly, the governance practices of the social organizations must adequate in ensuring effective
delivery of the social objectives.

1.2 Governance Framework Model for Philanthropic Organisations

Organisations with good governance are more able to achieve their objectives effectively. In this
context, governance has a strong relationship with accountability where organisations are responsible
to demonstrate how well they have achieved their objectives to the relevant stakeholders. More
recently, the concept and definition of accountability in social organisations continue to evolve as
these organisations flourish into new paradigm such as social business engagement and operation
across borders with additional stakeholders to be accountable to. In line with this proposition, this
paper argues that the main antecedents of good governance in social organisations are accountability,
anti money laundering and terrorism financing and risks management practices.

Accountability has been defined in numerous ways in the social sector. Irrespective of these
variations, Ebrahim (2003) argued that it is vital to examine the accountability issues from an
integrated perspectives as these organisations deal with multiple and contra accountability demands.
As such, the accountability concept perhaps takes priority over the user-needs model. For profit
organizations, they have direct economic agenda and successively an acknowledged financial bottom
line that rules all other forms of performance and accountability. In contrast, social organisations
lack of a bottom-line and multiple ‘uncertain’ accountabilities make it different to the profit sector
(Mulgan, 2000).

The multiple accountability concepts in the social sector have attracted scholars to conduct a
research to show how the sector manages its relationship with different stakeholders (Flack, 2007).
Social organisations in principle have to operate honestly and optimally to maximise their
organisational impact. Thus, it can be argued that the absolute humanitarian motive of social
organisations avoids the need for them to account. However, in practice this statement may not
necessarily be true and the demand for accountability becomes validated. While the stakeholders and
funders in social organisations are akin to shareholders (Ebrahim, 2003), they are unlikely to monitor
these organisations as closely as shareholders might for profit organisations. Nevertheless, they are
more possible to end their support if their trust fades as their personal welfare is not necessarily
dependent upon this support. Accordingly, scholars in accountability for social organisations like
Najam (1996) identify three categories of stakeholders: patrons (upward accountability); clients
(downward accountability) and the organisations (lateral accountability). Christensen and Ebrahim
(2006) also suggest similar accountability for social organisations: (1) upward to individual donors,
funders, and their national voluntary agency; (2) laterally to one another and themselves, as well as to
the staff, volunteers, community board members, and the community agencies with whom they work; and (3) downward to their clients and beneficiaries and the local community.

In the social sector, accountability to whom is complicated due to multiple stakeholders. Commonly, social organisations are accountable to stakeholders who are the funders, patrons, regulators and government; clients or community and to themselves and their missions (Ebrahim, 2010; Edwards and Hulme, 1996a; Kearns, 1996; Najam, 1996). Ebrahim (2010) also state that the accountability to whom concept varies with organization type, for example social organisations with membership and a service delivery social organisations like hospital and university.

Subsequently, there are some dispute arises in term of which stakeholders should get the priority (Ebrahim, 2003). It becomes more confusing where it involve various stakeholders and hierarchical demand of accountability. In general, social organisations tend to say that the upward stakeholders should get the priority because they are the one who contribute to the organisations. However, Ebrahim (2003, 2005) noted, “that an unjustified focus on hierarchical accountability can be damaging to social organisation because this leads to a focus of accountability to purely upward stakeholders (i.e. donors, government and funders), which can result in a narrowing of accountability relationships”. These concerns lead Christensen and Ebrahim (2006) to suggest social organisations should focus on accountability towards lateral and downward stakeholders, as strengthening this direction of accountability helps foster better relationships with beneficiaries and also helps gain legitimacy (Slim, 2002). Based on the multiple stakeholders perspective, this paper identifies two main groups of accountability, functional accountability and social accountability.

1.3 Functional accountability

Functional accountability is short term in orientation, focusing on accountability from social organisations to funder organisations for resources, resource use, and immediate impacts (Ebrahim, 2003a, 2003b; Edwards and Hulme, 2002a, 2002b; Najam, 1996). Similarly, O’Dwyer and Unerman (2007) mention that functional accountability are concerned principally with accounting for, and the use of, resources. In Dhanani and Connolly (2012), the functional accountability containing two type of accountability themes which are fiduciary and financial accountability. This is based on the classification scheme adopted by O’Dwyer and Unerman (2007). Fiduciary accountability emphasizes probity and compliance, and at an operational level, good governance and control (Brody, 2007). It is concerned with the professionalism which organizations are run and the upholding of their funds, assets and future (Keating and Frumkin, 2003). According to the Accountability Charter, disclosures relating to fiduciary accountability include details of governance structures and processes and policy details to confirm the safeguarding of organizational funds. Examples of fiduciary accountability in the annual report are governance and decision making, risk management and trustee and investment policy.

Financial accountability on the other hand is concerned with their financial outlook and the main trends and factors underlying their financial development. Tuckman and Chang (1991) and Global Reporting Initiative (GRI) (2010) indicate that the financial accountability is significant due to the reason that NPOs need to account for their financial position to convey the operational continuity, stability and viability of the organization and also the efficiency with which they operate. This is supported by Di Zhang and Swanson (2013) who state that “enhanced financial accountability was positively related to financial performance in their study”. Dhanani and Connolly (2012) further state that financial accountability concerns a wide area because it has implications for organizational sustainability and stability. Examples of items under financial accountability in the annual report are income and expenditure review, financial policy and fundraising activity.
1.4 Social accountability
In the era of social enterprise, the social organisations try to move beyond functional accountability focus to embrace broader scope of accountability in delivering their social impacts (social accountability). Social accountability can be defined as a measure of an organization’s commitment to its mission, its stakeholders and the greater community and demonstrates fulfilment of the requirements and expectations of tax-exempt organizations (Social Accountability Study Report, 2010). Others like McGee and Gaventa (2011, p.2) and Ringold, Holla, Koziol and Srinivasan (2012, p.7) define social accountability as “a set of tools or process that a resident can use to influence the quality of service delivery by holding providers accountable”. In this paper, the term social accountability refers to the impact of social organisations ability to produce in term of societal demand. In particular, the social accountability herewith has been seen as “the mechanism to ensure that resources are used according to legal procedures, professional standards, and societal values” (Brinkerhoff 2004).

Dhanani and Connolly (2012) in their study based on classification scheme adopted by O’Dwyer and Unerman (2007), grouped strategic and procedural accountability as constructs of social accountability that capture the social impact of an organization. Strategic accountability is associated with social organisations core purpose such as: organizational intentions (vision and mission); organizational actions (activities and programs to fulfill the intentions); and results (which measure the impact of their actions and the extent to which the intentions have been achieved (Goodin, 2003 ; Keating and Frumkin, 2003). Meanwhile, procedural accountability relates to internal organizational operations and is designed to confirm that management processes and procedures represent societal norms and beliefs. It also addresses the diverse parts of social organisations more directly and ensures that an organization’s social profit is not only limited to the cause that it works towards but is distributed more widely and fairly (Bouckaert and Vandenhove, 1998) such as ethical operation policies on investment, trading, fundraising and volunteers.

1.5 Shariah review
In developing the social PPP model with funded by Islamic social finance, it is important to develop an audit or review mechanism to ensure that the relevant activities are Shariah compliant. In particular, there is a need to link the concepts of Shariah audit or review in terms of its functions, socio-economic development, principles, strengths, and weaknesses in the Islamic Based business environment. In addition, the Shariah audit or review must be incorporated into a sound system of controlling and monitoring to ensure effectiveness in the delivery system. Since the Islamic modes of auditing (Shariah audit) are dealing with business activities and operations in an environment which are interest-free, the modes of delivering services and products becomes crucial in ensuring Shariah compliant.

1.6 Anti-money laundering and terrorism financing risks
In the context of money laundering and terrorism financing, the attacks of September 11, 2001 in the United States (USA) initiated a global recognition of such fundings through legitimate social organisations. Following this incident, Financial Action Task Force (FATF) had implemented the Special Recommendation VIII specifically for social organisations to prevent the misuse of this sector for terrorist financing. In addition to FATF, other organizations have also been set up to undertake functions for development and promotion of national and international policies to combat money laundering and financial terrorism. Such organizations include the Caribbean Financial Action Task Force (CFATF), Asia/Pacific Group on Money Laundering (APG) (for Asian Countries), Council of Europe Group (PC-R-EV), The Eastern and Southern African Anti Money Laundering Group (ESAAMLG), South American Anti Money Laundering Group (GAFISUD) and Middle East and North Africa Financial Action Task Force (MENAFATF).
In mitigating the abuse of social organisations as conduit for money laundering and terrorism financing, FATF had outlined a Special Recommendation (SR) VIII specifically for social organisations. One important recommendation is the promotion of transparency. This is to enhance confidence and trust in the sector as well as the general public. In achieving transparency, four elements are suggested to all member countries: (1) outreach to the non-profit sector regarding terrorist financing issues (2) supervision or monitoring of the non-profit sector (3) effective information gathering and investigation and (4) effective capacity to respond to international requests for information about social organisations of concern.

1.7 Risks management practice
Identification and management of risks are integral to effective governance in any social organisations. Social organisations are equally exposed to an array of risks such as funding risks, reputational risks and capacity risks that can subsequently have a negative impact on the sustainability of their organisations. Some of these risks are unique due to the characteristics of the social organisations, such as types of funding, non-profit maximization and the use of volunteers. Regardless of the types of risks, social organisations can mitigate these risks if there is an anticipated plan of risk management (Laroche & Corbette, 2010; Rudge, Tilley, Truswell, Falconer, Brown, Lowe, Antwi, Beeson, Fambegbe, Li, Tedder & Woollard, 2013). However, for effective risks management, it is crucial to identify the risks, analyze the risks identified and monitor the risk management process. The availability of effective risk management in social organisations allows the board to concentrate on strategic planning and other matters to ensure long term sustainability of their organizations in delivering their social objectives. It is important that board of directors in NPOs understand the importance of being engaged in decisions on key risks so that they can reduce environmental uncertainty and dependence.

2. METHODOLOGY
The categories of governance practices in this study are guided by the review of prior studies relevant to governance of non-profit organisations (e.g. Ebrahim, 2010 and Ebrahim & Weisband, 2007), mandatory disclosures as required by the Societies Act 1966, recommended practices by various regulatory authorities as well as industry practices. Of relevance is recommended practices in relation to governance and accountability of non-profit organisations based on Financial Action Task Force (FATF) report, Asia Pacific Group (APG) Mutual Evaluation 2007 and APG Typology 2011. FATF is a policy-making body established in 1989 that is responsible in the development of legislative and political reforms in the areas of anti-money laundering and terrorism financing. Compliance with recommended practices by FATF for NPOs operating in the Asia Pacific region is assessed by APG. Malaysia became member of the APG on 31 May 2000 and received partial compliance during the first audit.

The categories and items of governance identified from the above are validated by several officials from CCM. The validated items are then compared to the contents of annual reports and BMK for 30 randomly selected NPOs. This is done to ensure that the items validated are reported by NPOs in Malaysia. If any items are not reported by any of the 30 NPOs, the items will be dropped from the validated list. The overall items of governance identified are operationalised through a governance information system. An example of this is shown in Diagram 3 below.
The governance information system consists of four main categories of governance or accountability: strategic and structure accountability, oversight accountability, talent and culture accountability and infrastructure accountability. In the above diagram, assessment for oversight accountability shows detail scores for the individual items under this category for Berbudi Kitchen. Once the scoring for all the four categories has been completed, the final report will be generated as below.

**ISOFIAS - Islamic Social Finance Accountability Assessment System Evaluation for BERBUDI KITCHEN**

**Organisation registered under Companies Commission of Malaysia (CCM)**

**Total Score Results Summary**

1. STRATEGIC AND STRUCTURE ACCOUNTABILITY: GOOD (68%)
2. OVERSIGHT ACCOUNTABILITY: GOOD (34%)
3. TALENT AND CULTURE ACCOUNTABILITY: GOOD (63%)
4. INFRASTRUCTURE ACCOUNTABILITY: AVERAGE (48%)

1. Strategic and Structure Accountability
   - Strategic Accountability: GOOD (56%)
   - Organisational Structure: AVERAGE (50%)
   - Risk management: GOOD (73%)
   - Companies Act 1965 **** for organisation registered with CCM: EXCELLENT (100%)
The overall score for Berbudi Kitchen is 57%. By using this system, the organisation will be able to identify specific areas of governance to be improved. The system can also contribute the following benefits to the regulators: profiling of the POs based on the extent of their governance practices, systematic monitoring based on the profiles and capability building in enhancing their good governance practices.

3. SUMMARY AND CONCLUSION

This paper is one of the first steps in developing a governance framework model for social PPP initiatives. In this regard, we developed a conceptual framework of good governance and the operationalisation of the framework through the governance information system. The relevant stakeholders in the social PPP model described in this paper can gain several implications from this framework. First, the POs can review their social mission to align with the move towards delivering measurable social outcome. This is particularly important in enhancing their social outcome and scope for growth and sustainability. Second, private organisations or investors can begin the process of consultation with willing social sector organisations to move towards the implementation of good governance by POs towards Taqyid al-Multaq and social investment approach. The social PPP model provides a platform for POs to enhance their capacity and capabilities which in turn enables the professionalisation of the sector and leads to greater effectiveness of social service delivery over time. Participation from all sectors allows for increase in scale, allow successful partnerships to be replicated in other social areas of concern and maximization of the overall impact to the targeted recipients.

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