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CONTENTS

Developing an Accountability Disclosure Index for Malaysian State Islamic Religious Councils (SIRCS): Quantity and Quality

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ABSTRACT

This study aims to develop an Accountability Disclosure Index (ADI) for Malaysian State Islamic Religious Councils (SIRC), concerning both quantity and quality. In this case, the quality of disclosure items was developed based on the qualitative characteristics, which rely on the International Financial Reporting Standards (IFRS) conceptual framework; namely, relevance, faithful representation, understandability, comparability and timeliness. Each characteristic was scored based on the 'benchmark' score, ranging from poor (1) to excellent (5). However, some of the characteristics have been modified to contextualize the SIRC study setting. Both quantity and quality of disclosure items index might contribute to a methodology for analysing and evaluating annual reports. Results show fifty-seven items of disclosure information, which were regarded by stakeholders relevant to be disclosed by the SIRC. Indeed, all these disclosure items should be disclosed in the SIRC annual reports, so as to meet the expectations of a wide range of stakeholders. With regard to the quality of disclosure, two different sets of qualitative characteristics for non-financial and financial statement disclosure were designed. All five qualitative characteristics were adapted to measure the quality of financial disclosure, whereas for non-financial disclosure, 'timeliness' was dropped due to the voluntarily nature of non-financial disclosure.

Keywords: *Accountability, disclosure, quantity of disclosure, quality of disclosure, State Islamic Religious Councils (SIRCs)*

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INTRODUCTION

In Malaysia, as elsewhere, there has been an increased public interest in government transparency, particularly concerning performance and service delivery of public entities such as ministries, government departments, agencies, local authorities and government linked-companies. The public has continued to demand the best standard of services and greater transparency. State Islamic Religious Councils (SIRCs) are one of the government agencies that have received significant attention from the public. A number of negative cases about SIRC were reported in the local media, such as the embezzlement of public funds and misconduct inquiries (*Berita Harian*, 2 March 2011; *Berita Harian*, 27 November 2011; *My Metro*, 1 November 2011; The Sun, Daily 24 November 2011 and The Sun Daily, 24 April 2010). The public, including contributors, service recipients and the community, have demanded their citizenry rights.

Wahid et al. (2009) found that reasons for public dissatisfaction may arise from ineffective distribution and insufficient dissemination of information concerning the distribution of public money. Consequently, as well as media enquiries, the various stakeholders, especially the public, demand their right to information about the activities and programmes for recipients of SIRC's funds. Greater transparency would enable the public to make an informed judgement on the SIRC's accountability. This shows a change in the relationship between the public and the SIRC, in which the public has moved from passivity to increased analysis and demands for transparency from the SIRC.

In order to respond to these criticisms, the content of the annual report in the overall accountability of SIRC is essential. In particular, being accountable for the funds received directly from the state and indirectly from the federal government[1], SIRC create substantial accountability chains which involve various constituencies of interest to the government and public interest. This implies that related information on accountability should be provided.

Following that, several disclosure studies have been conducted on public sectors, which can be sub-grouped into different levels encompassing

1 SIRCs receive a grant from the federal government through the allocation of the state government.

federal bodies, state government, local authorities and other government agencies like universities and schools. This includes not-for-profit organisations (NPO) like charities and religious organisations. However, Jeatty and Bettie (2008) caution that disclosure practice is subject to the varying target audience and purpose of the report. The entire non-profit organisations are relevant to this study because of the uniqueness of the SIRC under review, which were established by the government to provide welfare in a religious setting.

However, local governments are the most investigated (Bakar & Saleh, 2011). Laswad et al. (2005) explain that there is a clear relationship between the tax payers as financial contributors and the local authorities. Similar to fund-raising charities, another area of research is NPO studies based on a premise of financial incentives (Arshad et al., 2013; Heijden, 2013; Atan et al., 2012; Zainon et al., 2011 and Hyndman, 1990) while others are under-research (Laswad et al., 2005). Indeed, this study can contribute to the scarce literature on statutory bodies by examining the SIRC disclosure practices. Two disclosure issues are drawn from previous literature, namely: content and quality of disclosure.

LITERATURE REVIEW

Content of Information Disclosure

As the contents of the public sector annual report are very often subject to the author's decision (Ryan et al., 2002), some important information about the reporting entity might be hidden (Flynn, 2012). Irrelevant and inaccessible information have impeded discharging accountability (Ismail & Bakar, 2011). Consequently, a considerable number of studies have been carried out to examine the extent and quality of disclosure in the annual report.

The key feature of disclosure for the NPO such as public sector, charities and NGOs is to satisfy stakeholders' needs (Dhanani & Connolly, 2012; Hyndman, 1990; Tooley et al., 2010). Various stakeholders have an interest in information about governmental entities and NPO for accountability discharge. Thus, identifying stakeholders' needs is crucial.

According to Freeman (1984), stakeholders are groups or individuals who can affect or are affected by the achievement of the organisation's objectives. Internal stakeholders can be identified easily in comparison with external stakeholders. This is because the former has a direct relationship because of the corporation's activities.

Masruki et al. (2016) carried out a questionnaire survey to identify disclosure items that should be disclosed by the SIRC. This is to identify information disclosure expected by a wide range of stakeholders, either internal or external. Both recommended practices i.e. State of Recommended Practices for charities in the UK (SORP) and Malaysian Treasury Circular (TC) for preparing annual reports in developing the disclosure index were used. The SORP is specifically for charities in the UK consistent with the functions of the SIRC for social welfare. The SIRC were established in the purview of the Malaysian government in a religious setting. Although TC is designed for statutory bodies in Malaysia, it applies to all governmental entities irrespective their functions. This implies that there are still many aspects to consider in promoting the best practice of reporting for the SIRC. Yet, the integration between national and international reporting guidelines is pertinent for the SIRC and other related bodies such as governments, NPO and religious-based organisations with apparently the best reporting practice. Indeed, disclosure index specifically for the SIRC is relevant to be used in order to meet the expectation of various stakeholders from the SIRC annual reports.

In Masruki et al. (2016) study, they reviewed several references to identify the disclosure items, which were included in their questionnaire. The list was prepared initially following minimum disclosure guideline for preparing and presenting financial statements and annual reports, in the Malaysian Government Treasury Circular (MGTC) 4/2007. Other reference sources were also considered, these include: (i) Public Administration Development Circular (PADC 2/2005) - Performance indicator and measurement; the Malaysian Financial Reporting Standards (MFRS); and the Government Accounting Standards (GAS or *Piawaian Perakaunan Kerajaan* or PPK); (ii) International standards and guidelines consisting of the International Public Sector Accounting Standards (IPSAS) and the UK Statement of Recommended Practice for Charity Bodies (SORP); and (iii) reviewed several NPO and government disclosure studies. Such

disclosure index is useful to evaluate the extent or the quantity of disclosure, specifically for SIRC. However, similar organisations might be of interest in this disclosure index.

Qualitative Characteristics of Disclosure

It is acknowledged in the literature that most researched disclosure studies evaluate the quantity of disclosure rather than disclosure quality. This is because of the subjectivity in assessing the quality of disclosure. However, it can be minimized by the identification of quality criteria, although such subjectivity cannot be completely removed (Marston & Shrives, 1991). Likewise, Beattie et al. (2004) also state that disclosure quality is a complex concept, multifaceted and subjective. In fact, there is a lack of theory to support the construction of the index. There are a variety of approaches to measure disclosure quality.

According to Beattie et al. (2004), there are two categories of measuring disclosure, namely subjective ratings and a semi-objective approach. Subjective ratings apply to score rankings for quality of disclosure, which involves subjective judgment and self-selection bias. Alternatively, the second approach of a self-constructed disclosure index is developed to measure the disclosure. This approach is explored in this study as Hassan et al. (2009) argue, demonstrating that the index used must be appropriate to the context of study. The disclosure index can be used to identify disclosure quality where it can be measured according to the degree of compliance (Tsalavoutas, 2011), detailed inclusion of sub-elements (Al-Razeen & Karbhari, 2004) and importance (Chakroun & Hussainey, 2014; Coy & Dixon, 2004; Hooks et al., 2002).

Information disclosure is useful if it is relevant and faithfully represents what it means to reflect on. It is more useful when it is enhanced with information for comparability, understandability and timeliness (IFRS, 2011). Relevance and faithful representation are two fundamental characteristics whereas enhancing characteristics are understandability, comparability and timeliness. **Both IFRS and IPSAS**[2] are related here to explicate the meaning of each qualitative characteristic as follows:

2 In Malaysia, it is known as MPSAS, which is based on International Public Sector Accounting Standards (IPSAS) published by the International Federation of Accountants (IFAC).

Relevance

The relevance of information is associated with its ability to assist users in evaluating, confirming, and correcting evaluation of events in the past, present or future. The relevant information can make a difference in the decisions of users, in particular if the information has predictive value (input to predict future outcomes), confirmatory value (feedback about previous evaluations - changes or confirmations) or both. Both predictive and confirmatory values are interrelated.

Faithful Representation

Information should faithfully represent transactions and other events according to their content and not just their legal form. The information is considered faithfully representative if it is complete, neutral and free from material error. It represents the resources, obligations, transactions and other circumstances of the reporting entity.

Understandability

For the disclosed information to be understandable, users are expected to have reasonable knowledge of the reporting entity's activities. This may convince them of their ability to comprehend the information. Any complex matters should also be included in the report because other users might easily understand the information. However, presentable information can enhance the understandability if it is categorised and characterised by a clear and concise presentation.

Comparability

The information allows users to identify similarities and differences provided in that report and others across entities and over time periods. However, users have to be informed about the policies used in the financial statements and reports, policy changes and their effects, and the preceding corresponding information. The report appears to be comparable if it helps users to look at the trends and performance of the reporting entity over certain periods.

Timeliness

Information should be provided on a timely basis, otherwise it may lose relevance and be of little use to users in influencing their decisions, especially those who need to make decisions in the interim. Timeliness has a quality attribute if the time taken to disclose the information is associated with the usefulness of decisions.

As such, this study adopts the Masruki et al. (2016) disclosure index, which was developed specifically for State Islamic Religious Councils (SIRC) together with the weighted importance. This is to assure that those items could meet the expectations of various stakeholders. In addition to the disclosure index to measure the extent of disclosure, this study aims to develop five qualitative characteristics to measure the quality of disclosure.

METHODOLOGY

A review of the disclosure literature was carried out to respond to a call of disclosure measurement issues. As this paper discusses the extent and quality of disclosure of the SIRC, both disclosure index with weighted importance and qualitative characteristics were emphasised. The disclosure index was adopted from Masruki et al. (2016). Moreover, the quality of disclosure is adapted from previous studies such as Beest et al. (2009) and Chakroun and Hussainey (2014). Since in Malaysia, there is no subjective rating of the quality of the annual report unlike most developed countries, adapting Beest et al. (2009) measurement to operationalise each qualitative characteristic is pertinent due to the similar framework used. Even so, some modifications of the characteristics were made to best suit with the SIRC setting, especially to reflect disclosure on the main income of the SIRC i.e. zakat.

RESULTS AND DISCUSSION

As shown in Table 1 below, fifty-seven (57) disclosure items were used (See Masruki et al., 2016), consisting of five categories, namely, corporate (7), strategic (5), financial performance (9), non-financial performance (8) and financial statement disclosure (28). The key feature of disclosure for non-profit organisations such as the SIRC is to satisfy stakeholders' needs

(Dhanani & Connolly, 2012; Tooley et al., 2010; Hyndman, 1990). Indeed, the different levels of importance for each of the disclosure items should be considered, to identify whether the current reporting practices meet the expectations of stakeholders.

The disclosure items were extracted from guidelines, statutory requirements and accounting standards, these are: Treasury Circular 4/2007, FRS - Financial Reporting Standards, PPK - Government Accounting Standards (GAS or *Piawaian Perakaunan Kerajaan* or *PPK*); PAD - Public Administration Development Circular (PADC 2/2005) - Performance indicator and measurement, SORP - UK Statement of Recommended Practice for charity bodies (SORP). In addition to that, numerous previous studies were referred to in identifying the disclosure items such as Yasmin et al. (2014); Hook et al. (2012); Dhanani and Connolly (2012); Connolly and Hyndman (2004); Coy and Dixon (2004). A list of disclosure items and their level of importance is presented in Table 1.

Table 1: Ranking of the Importance Level of Disclosure Items for SIRC

No.	Level of Important	Disclosure Items	Category	Min	Max	SD	Mean
1	Very Important	Balance Sheet	FS	2.00	5.00	0.71	4.44
2		Performance and Achievement	SI	1.00	5.00	0.70	4.40
3		Financial Review	FP	2.00	5.00	0.70	4.40
4		Income Statement	FS	2.00	5.00	0.73	4.37
5		Statement of Cash Flows	FS	2.00	5.00	0.74	4.35
6		Total Expenditure	FS	2.00	5.00	0.72	4.34
7		Looking-Forward Information	SI	1.00	5.00	0.76	4.33
8		Audit Certificate	FS	2.00	5.00	0.75	4.33
9		Current Assets	FS	1.00	5.00	0.73	4.32
10		Total Revenue	FS	2.00	5.00	0.74	4.32
11		Summary Facts and Figures	SI	1.00	5.00	0.72	4.30
12		Current Liabilities	FS	1.00	5.00	0.74	4.30
13		Auditor Index Rating	FS	1.00	5.00	0.76	4.28
14		Establishment and Operation	CI	1.00	5.00	0.74	4.26
15		Revenue by Source of Funds	FS	2.00	5.00	0.72	4.25
16		Surplus/Deficit	FS	1.00	5.00	0.74	4.25
17		Actual-to-Budget Comparison	FP	1.00	5.00	0.79	4.22
18		Revenue by Service Rendered	FS	1.00	5.00	0.76	4.22
19		Notes to the Accounts	FS	2.00	5.00	0.73	4.22
20		Financial Performance Ratios	FP	2.00	5.00	0.72	4.20
21		Expenditure by Activities/ Income by Activities	FP	2.00	5.00	0.73	4.20
22		Expenditure by Services	FS	1.00	5.00	0.73	4.20
23		Expenditure by Functions	FS	1.00	5.00	0.77	4.20
24		Long-Term Investments	FS	2.00	5.00	0.81	4.19

25		Ethical Operational Policies	CI	1.00	5.00	0.85	4.18
26		Administration to Total Expenses	FP	2.00	5.00	0.75	4.18
27		Reserves	FS	1.00	5.00	0.78	4.18
28		Programme Expenses/Total Expenses	FP	2.00	5.00	0.73	4.17
29		Output	NFP	2.00	5.00	0.70	4.17
30		Customer Satisfaction Measures	NFP	1.00	5.00	0.79	4.17
31		Long-Term Liabilities	FS	1.00	5.00	0.78	4.17
32		Other Recognised Gains/ Losses	FS	1.00	5.00	0.76	4.16
33		Total Fund Carried Forward (c/f)	FS	1.00	5.00	0.78	4.16
34		Administration and Governance Costs	FS	2.00	5.00	0.76	4.15
35		Total Fund Brought Forward (b/f)	FS	1.00	5.00	0.79	4.15
36		Efficiency	NFP	1.00	5.00	0.74	4.14
37		Statement of Assets and Liabilities	FS	1.00	5.00	0.86	4.14
38		Performance Target and Objectives	NFP	1.00	5.00	0.78	4.13
39		Outcome	NFP	2.00	5.00	0.74	4.13
40		Investment	FP	2.00	5.00	0.77	4.11
41		Effectiveness	NFP	2.00	5.00	0.75	4.10
42		Total Non-Current Assets at Cost	FS	2.00	5.00	0.77	4.10
43		Government Borrowing/ Grants	SI	1.00	5.00	0.83	4.09
44		Productivity Measures	NFP	2.00	5.00	0.79	4.09
45		Other Incoming Revenue	FS	1.00	5.00	0.78	4.09
46		Purpose and Objectives	CI	1.00	5.00	0.77	4.08
47		Board of Directors	CI	1.00	5.00	0.82	4.08
48		Input	NFP	1.00	5.00	0.75	4.08
49		Long-Term Debtors	FS	1.00	5.00	0.87	4.08
50		Structure of Organisation	CI	2.00	5.00	0.80	4.06
51		Investment Income/Average Investment	FS	2.00	5.00	0.77	4.05
52		Deferred Liabilities	FP	1.00	5.00	0.85	4.05
53		Deferred Credit from Government Grants	FP	1.00	5.00	0.90	4.02
54	Quite Important	Net Rental Income and Expenses/Rental Income	FS	2.00	5.00	0.77	3.99
55		Chairman's Report	SI	1.00	5.00	0.89	3.94
56		Personnel Development	CI	1.00	5.00	0.94	3.77
57		Personnel	CI	1.00	5.00	0.90	3.70

Source: Masruki et al. (2016)

Regarding quality of disclosure, a comprehensive measure to operationalise the qualitative characteristics of a comprehensive annual reports was adapted from Beest et al. (2009), involving both fundamental and enhancing qualitative ones. Each of the qualitative characteristics was identified with their scale of measurements out of five measures. The sub-score for each attribute in every qualitative characteristic represent the qualitative framework as proposed by the International Accounting Standard Board (IASB), which has also been adapted in Malaysia as the Malaysia Financial Reporting Standards (MFRS). Tables 2 and 3 list details of the operationalisations of the qualitative characteristics and scales of their measurements respectively, for financial statement and non-financial statement disclosure.

Table 2: Measurement Scales Used to Operationalise the Qualitative Characteristics for Financial Statements

No.	Operationalisations	Scale of Measurements
Relevance (1)		
R1	To what extent does the presence of financial breakdown on *zakat/ waqf* help to form potential funds opportunities and challenges in SIRCs?	1 = No financial breakdown figures 2 = Financial breakdown figures not in separate subsection 3 = Separate subsection 4 = Extensive prediction 5 = Extensive prediction useful for making expectation
Faithful Representation (3)		
F1	To what extent are valid arguments provided to support the decision for certain assumptions and estimates in the financial statements?	1 = Only described estimations 2 = General explanation 3 = Special explanation of estimations 4 = Special explanation, formula explained etc. 5 = Comprehensive argumentation
F2	To what extent does the SIRC base its choice for certain accounting principles on valid arguments?	1 = Changes not explained 2 = Minimum explanation 3 = Explanation with reasons 4 = Explanation with reasons + consequences 5 = No changes or comprehensive explanation

F3	Which type of auditors' report is included in the financial statements?	1 = Adverse opinion 2 = Disclaimer opinion 3 = Qualified opinion 4 = Unqualified opinion: Financial figures 5 = Unqualified opinion: Financial figures + internal control
Understandability (3)		
U1	To what extent are the financial statements presented in a well-organized manner?	1 = Very bad presentation 2 = Bad presentation 3 = Poor presentation 4 = Good presentation 5 = Very good presentation
U2	To what extent are the notes in the balance sheet and income statement sufficiently clear?	1 = No explanation 2 = Very short description, difficult to understand 3 = Explanation that describes what happens 4 = Terms are explained (which assumptions etc.) 5 = Everything that might be difficult is explained
U3	To what extent is the use of language and technical jargon in the financial statements easy to follow?	1 = Much jargon (industry), not explained 2 = Much jargon, minimal explanation 3 = Jargon is explained in text 4 = Not much jargon, or well explained 5 = No jargon, or extraordinary explanation
Comparability (1)		
C1	To what extent did the SIRC adjust the previous accounting period's figure, due to the implementation of a change in accounting policy or revisions in accounting estimates?	1 = No adjustment 2 = Described adjustment 3 = Actual adjustment (one year) 4 = 2 years 5 = 2 years + notes
Timeliness (1)		
T1	How many days does it take for the auditor to sign the auditors' report after book-year end?	Natural logarithm of amount of days: 1 = 1-1.99 2 = 2-2.99 3 = 3-3.99 4 = 4-4.99 5 = 5-5.99

Two different sets of 11 qualitative characteristics for non-financial and for financial statement disclosure were designed as shown in Table 2 and 3 respectively. All five characteristics were adapted to measure the quality of financial disclosure, whereas for non-financial disclosure, 'timeliness' was dropped due to the voluntary nature of non-financial disclosure. Details of the operationalisations of the qualitative characteristics and scales of their measurements for non-financial and financial statement disclosure are presented accordingly.

Table 3: Measurement Scales Used to Operationalise the Qualitative Characteristics for Non-Financial Disclosure

No.	Operationalisations	Scale of Measurements
Relevance (2)		
R1	To what extent does the presence of looking-forward statement help to form expectations and predictions concerning the future of the SIRC?	1 = No looking-forward information 2 = Looking-forward information not in an apart subsection 3 = Separate subsection 4 = Extensive prediction 5 = Extensive prediction useful for forming expectation
R2	To what extent the presence of non-financial information in terms of potential fund opportunities and challenges complement financial information?	1 = No non-financial information 2 = Little non-financial information, no useful for forming expectations 3 = Useful non-financial information 4 = Useful non-financial information, helpful for developing expectations 5 = Non-financial information presents additional which helps to develop expectations
Faithful Representation (3)		
F1	To what extent are valid arguments provided to support the decision for certain assumptions and estimates in the annual report?	1 = Only described estimations 2 = General explanation 3 = Special explanation of estimations 4 = Special explanation, formula explained etc. 5 = Comprehensive argumentation
F2	To what extent does the SIRC, in the discussion of the annual result, highlight positive events as well as the negative?	1 = Negative event only mentioned in footnote 2 = Emphasize on positive events 3 = Emphasize on positive events, but negative events are mentioned, no negative events occurred 4 = Balance positive/negative events 5 = Impact of positive/negative event is also explained

F3	To what extent does the SIRC provide information on corporate governance?	1 = No description CG 2 = Description on CG limited, not in separate subsection 3 = Separate subsection 4 = Extra attention paid for information concerning CG 5 = Comprehensive description of CG
Understandability (3)		
U1	To what extent is the annual report presented in a well-organized manner?	1 = Very bad presentation 2 = Bad presentation 3 = Poor presentation 4 = Good presentation 5 = Very good presentation
U2	To what extent does the presence of graphs and tables clarify the presented information?	1 = No graph 2 = 1-5 graphs 3 = 6-10 graphs 4 = 11-15 graphs 5 = > 15 graphs
U3	To what extent is the use of language and technical jargon in the annual report easy to follow?	1 = Much jargon (industry), not explained 2 = Much jargon, minimal explanation 3 = Jargon is explained in text 4 = Not much jargon, or well explained 5 = No jargon, or extraordinary explanation
Comparability (3)		
C1	To what extent does the SIRC provide a comparison of zakat collection and distribution in the current period compared to previous periods?	1 = No comparison 2 = Only with previous year 3 = With 5 years 4 = 5 years + description of implications 5 = 10 years + description of implications
C2	To what extent is the information in the annual report comparable to the information provided by other SIRCs?	1 = No comparability 2 = Limited comparability 3 = Moderate comparability 4 = Very much comparability 5 = Very extensive comparability
C3	To what extent does the SIRC present financial index numbers and ratios in the annual report?	1 = No ratios 2 = 1-2 ratios 3 = 3-5 ratios 4 = 6-10 ratios 5 = > 10 ratios

CONCLUSION

The quantity and quality of disclosure are both important aspects in preparing annual reports to meet the expectations of various stakeholders. The uniqueness of the SIRC under review, which was established in the government purview to provide welfare in a religious setting, has led to the importance of discharging accountability. It is acknowledged in many studies that an annual report is the best medium to discharge accountability of the reporting entity. Indeed, the SIRC should assure that they have a comprehensive annual report for discharging their accountability. It is believed that issuing annual reports is the best way to respond to public inquiries on the accountability of the SIRC as reported in the local media. As such, this study provides some insights into the best reporting practices for the SIRC and other similar organisations, such as charities, NPO and other government agencies. Further research that expands the disclosure items and quantity dimensions could be further refined by validating from key users of the reporting entities.

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