

CHAPTER 1

INTRODUCTION

1.0 Introduction

Internal controls are part of an organisation's internal control system. These internal control practices shape the procedures to ensure sound and effective organisational operations and protect the organisation from fraudulent or opportunistic behaviour while abiding by the relevant laws and regulations. The internal controls regulate the financial process to improve the reliability and credibility of financial reporting (Kewo and Afiah, 2017; Krishnan, 2005). They also constitute a primary mechanism to enhance an organisation's accountability. In order to ensure that the outputs (financial statements) are reliable and high quality, the inputs should be subject to proper processes. Providing financial statements with high quality financial information will enhance the confidence of the stakeholders in investment, credit, and the allocation of existing resources to the organisation (IASB, 2008). Similarly, for non-profit organisations, quality financial reporting will enhance trust in the efficiency of the organisation and attract more donors and allocation of resources.

Therefore, the internal control a management tool to discharge its accountability to the organisation's stakeholders (Ihsan et al., 2006). The foundation of a sound system of internal controls is an organisational plan and structure that ensure the adequate separation of duties and functions. These include: (1) A system of authorisations and

procedures which provide realistic accounting controls; (2) A firmly established system which prescribes the details and functions of each organisational unit and applies sound practices and adequate procedure; (3) Trained, experienced and adequate staff capable of carrying out the responsibilities; (4) Prescribed standard of performance; and (5) a complete internal audit unit possessing the maximum independence (COSO, 2013).

Furthermore, it is imperative to emphasise the unique nature of accountability in Islam, where it has a broader scope compared to conventional accountability concepts, including those applied in charitable institutions. In Islam, every individual human has dual accountability, one to the worldly community, and the other to Allah Almighty in the Hereafter. Therefore, all the human beings are Khalifah (i.e., vicegerent) of Allah almighty and they are responsible for all funds and resources which has been entrusted in their hands; as well they are obligated to fulfil any agreement made between them (Maliah et al., 2008; Ihsan and Adnan, 2017; Ihsan and Ayedh, 2015). This unique Islamic accountability is considered idealistic and applicable to the Waqf institutions.

Waqf practices vary from one country to another due to the resilience of Waqf institutions, which leads to autonomy and less restrictions, especially in terms of managing Waqf institutions. Calls to standardise Waqf practices, especially accounting and accountability, are increasing (Ayedh and Ihsan, 2013; Ihsan and Ayedh, 2015).

According to Johari et al. (2016), the cornerstone to improving the management systems of Waqf organisations is having an effective internal control system. Effective internal controls of income receipts and disbursement of endowment/donation, segregation of duties, qualification of staff and advisers, and a sound internal control practices on accounting disclosure and good governance will enhance the financial and

non-financial transparency level which will lead to better marketability of the Waqf organisations (Ihsan et al., 2006; Sulaiman, 2007; Karim, 2010).

Generally, funds (donations) are the primary source of funding for non-profit organisations. Accounting systems highlight accountability instead of profitability. Generally, the practices of non-profit (Waqf) organisations or government agencies in reporting financial statements focus on daily transactions instead of profit. Therefore, it is called fund accounting. The internal control influences accountability, particularly in religious non-profit organisations. For instance, Fonfeder et al. (2003) investigated the internal control practices of the Jerusalem Temple and found inappropriate record keeping practices that only concentrated on recording cash, which prevents the temple from tracking and optimising the use of all the gathered financial resources. In Malaysia, Sulaiman et al. (2008) studied ten mosques in different states and found that the staff and committees lack information of sufficient internal control practices and had non-standardised financial reporting, which reflects weak internal controls. This study examines the Al-Rahma International Waqf Institution as evidence to study the internal control practices and accountability practices.

1.1 Research Problem

Al-Rahma International is one of the largest Waqf institutions which has more than 40 branches around the world. It was established in Kuwait in 1982. Al-Rahma International received an award of transparency in 2012 and received ISO 9001:2015 on 26.06.2018 Djibouti Branch. These quality certifications and awards are consequences of effective internal controls and show a remarkable culture of the need of internal controls in Al-Rahma International. This suggests that Al-Rahma International discharges its accountability to its stakeholders (donors). In the General

Meeting of the Social Reform Society, the secretary general, Mr. Abdullah Al Otaiqi, confirmed that the independent auditor's report issued by Al-Aiban and Al-Osaimi and their partners was received by Waleed Al-Osaimi, the auditors' account number (68). Moreover, Al Otaiqi said that Al-Rahma must adhere to the procedures of internal controls efficiently and effectively.

The Ministry of Social Affairs on 14th October 2018 publicised Al-Rahma International for an unlimited period, and Al-Rahma International constitution's summary is published in Kuwait's official newspaper (Alnaba issued: 12791) that Al-Rahma International is registered as a non-profit organisation based in the State of Kuwait to foster social solidarity in Kuwait. When Al-Rahma transformed into an international organisation, it became obligated to exercise greater levels of accountability in the context of performance measurement, evaluation and reporting. Al-Rahma is also obligated to its donors to implement charitable projects professionally to satisfy the donors. The average yearly Funding of Al-Rahma is 13 million Kuwaiti Dinars, which is equal to 43 million US dollars. Since Al-Rahma operates its activities internationally, implementing its internal controls become more challenging and requires high levels of efficiency and commitment to applying internal control procedures.

The internal control practices apply several mechanisms to ensure and assess the organisational financial regulatory compliance process. According to COSO (2013) and IFAC (2012), these mechanisms are the control environment, risk assessment, control activities, information and communication and monitoring. In addition, the internal control mechanisms need to work together to form a robust set of methods and procedures that the organisation follows in its operations.

Unlike profit organisations that have stakeholders, Waqf organisations, as social non-profit organisations, provide social services to the community, and the relationship between accountability and internal control practices is not clearly defined (Ayedh and Ihsan, 2013; Rashid, 2008; Maliah et al., 2008; Ihsan and Ayedh, 2015).

Furthermore, a sound internal control practices comprise detailed procedures and records adopted by the administration and mostly deal with the reliability of financial reports and records along with assets protection (Johari et al., 2016; Sulaiman, 2007; Karim, 2010). Therefore, it is very important that the non-profit organisation (Waqf) ensures and fulfils these fundamentals internal controls to ensure the effectiveness in operations and better accountability. Non-profit organisations (Waqf) receive donations from donors (waqifs) and assets such as cash and money, and require an effective internal control practices for the appropriate management and maintenance of these resources to fulfil their duty of accountability to the management (Muttawali) (Maliah et al., 2008; Ihsan and Ayedh, 2015).

The pressure to undertake monitoring and evaluation in non-profit (Waqf) organisations is more than profit organisations, and present measurable indicators of output, impact and capacity (Petrovits et al., 2009; Hailey, 2003). Thus, greater attention has been directed to the managerial challenges of non-profit organisations (Waqf) facing the challenge to establish efficient and effective internal control mechanisms.

The internal controls in profit organisations have been studied more than in non-profit organisations. Thus, there is a need to assess the efficiency and effectiveness of the internal controls practices in Waqf (non-profit) organisations to improve the Waqf organisations' accountability and performance (Sulaiman, 2007; Karim, 2010).

Waqf management is accountable to convey data about social reality to satisfy current investors and different partners (Mohiddin and Nooraini, 2015). According to

Yasmin et al. (2014), the connection between religion and responsibility has been perceived as an individual trademark and a social factor that affects hierarchical leadership. Islam places extraordinary emphasis on accountability and morality, with imparted accountability not being simply to satisfy social commitments but rather to satisfy the religious obligation. Accountability from the Islamic concept extends the scope of answerability to Allah (the Creator) as the Judge and Ruler of man. Nowadays, there is a call for accountability to be consistently stated for organisations, government agencies and non-profit organisations. It is critical to government and non-profitable organisations since their objectives are not revenue driven and the reserve may effectively be abused by the management (Sapingi et al., 2014). Finally, there is lack of empirical studies investigating the interconnection between the internal control mechanisms and accountability in non-profit (Waqf) organisations.

1.2 Research Questions

Based on the discussion above, the research seeks to answer the questions below:

1. What are the internal control systems in the Al-Rahma International Waqf Institution?
2. What are the accountability practices in practices the Al-Rahma International Waqf Institution?
3. What is the role of the internal control practices in enhancing the accountability in the Al-Rahma International Waqf Institution?

1.3 Research Objectives

1. To explore the internal control practices in the Al-Rahma International Waqf Institution.

2. To examine the accountability practices in the Al-Rahma International Waqf Institution.
3. To examine the role of these internal control practices in enhancing accountability in the Al-Rahma International Waqf Institution.

1.4 Significance of the Study

Al-Rahma International as selected as the Waqf institution because this organisation has been established for more than 30 years in Kuwait and is considered one of the largest international non-profit Waqf organisations. It has more than 40 branches all over the world.

By studying Al-Rahma International, Al-Rahma International will benefit as an empirical academic evaluation of its process of internal controls. The findings might be a benchmark for other Waqf organisations in the evaluation and improvement process. In addition, this research is set to increase the awareness of the importance of internal control practices within non-profit organisations.

This research evaluates the practice of internal control practices and cultivates awareness of significant issues with recommendations to resolve them. This research is also expected to increase Al-Rahma's monitoring function and overall evaluation of their internal control practices for sustained higher operational efficiency.

The study will enable donors in following and monitoring their activities using the proper controls to ensure minimal misappropriation/misuse of such funds.

1.5 Scope of the Study

The scope of the current study is confined to Waqf organisations. However, due to time constraints, only Al-Rahma International (Waqf organisation) has been selected.

The target respondents are the managerial staff in all 40 branches under Al-Rahma International involved directly in the internal control practices such as financial employees, accountants, managers, and directors involved in the internal control practices like authorising payment vouchers and signing checks.

1.6 Operational Definition

The following definitions are the key terms used in this study:

1.6.1 Internal Controls (IC)

An internal control practices is defined as a set of policies and procedures intended to ensure that the organisation's assets are protected, and the financial reporting are reliable (Sulaiman et al., 2008). The internal control might deliver only rational assurance, not absolute assurance, in regard to accomplishing an organisation's objectives. Applying an appropriate system would assist the organisation's operations become better organised and effective (Sulaiman et al., 2008). Even though internal control practices work at various levels of efficiency, be effective, it requires risk assessment processes, sound operational control activities, effective information and communication system and effective evaluation and monitoring systems (COSO, 1992). These five internal control components are interconnected and make up an effective internal controls system.

1.6.2 Waqf

Waqf literally means "stopping binding" or "keeping in custody, detaining closing or imprisoning and should not be sold but frozen for giving in the name of Allah" (Ihsan et al., 2006). Waqf is also defined as an endowment title for specific possessions where the usufruct is dedicated to public welfare.

1.6.3 Accountability

Accountability is defined as the foundation for measuring performance, reporting and evaluation. Accountability from a managerial perspective of management is to question the higher authority for the production of outputs or the resources usage in order to accomplish certain ends and hold the relevant people responsible and answerable for their actions (Ihsan et al., 2006).

1.6.4 Accountability in the Islamic Perspective:

In Islam, accountability (*taklif*) is the responsibility of every Muslim. Every Muslim is accountable for their actions on the Judgement Day. The Qur'an states, "*Then shall anyone who has done an atom's weight of good, see it*" (Qur'an, 99:7). Similarly, Haniffa (2001) explains the concept of the ultimate accountability in Islam is to Allah since, in the Hereafter, every deed is held to account. Haniffa supported her idea with the following verse of the Holy Qur'an: "*To Allāh belongs all that is in the heavens and on earth. Whether you show what is in your minds or conceal it, Allāh will call you to account for it*" (Qur'an, 2:284).

According to Imam al-Ghazali, Muslims must keep in mind that spiritual and temporary affairs are strongly connected in their life. Consequently, all = worldly deeds like studying worldly majors, working, and trading are ways of worshipping *Allah*, since they are in line with the Islamic rules and policies (*Islamic Shariah*), which encourages seeking a good life and human well-being (*Book of Ihya Ulum Al-Din*) (Ihsan and Ayedh, 2015).

1.7 Limitations of the Study

The current study scope is limited to one Islamic Waqf institution named Al-Rahma International. It focuses on the employees related to the internal control and accountability practices in Al-Rahma International.

1.8 Organisation of the Thesis

This thesis comprises five chapters. The first chapter introduces the research by canvassing the background of the study with emphasis on the internal controls systems, particularly in non-profit organisations. It comprises the research problem, research questions, research objectives, the study significance, the study scope and the organisation of the thesis.

The second chapter reviewed the literature related to the internal controls systems and accountability in non-profit organisations, particularly in Waqf organisations.

The third chapter presents a comprehensive of the methodology which is used in implementing the research. It clarified the research design, the population and sampling method, the collection of data and instrumentation, and explained the analysis of the collected data.

The fourth chapter analysed the data and extrapolates the findings. It explained the editing and coding of data, response rate, data screening for missing data, demographic results and analysis of the findings.

The last chapter discussed the summary results of this study and provided suggestions and recommendations for future research based on the results. Based on the previous chapters, this chapter ended with overall conclusions of the study based on the evidence.