

# Associations between organizational specific-attributes and the extent of disclosure in charity annual returns

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**Abstract**— Researchers have investigated associations between organizational specific-attributes and the extent of disclosures in charity organizations. Findings have consistently shown the organizational performance, size and the external governance mechanism are significantly associated with the extent of disclosure, while mixed results have been reported for non-financial performance, and the internal governance mechanism such as board size and board composition. The purpose of this paper is to further extend the examination of the associations between the organizational specific-attributes and the extent of disclosure. The results of multiple regression analysis of 65 charity organizations confirm significant and positive association between the extent of disclosure and financial performance, organizational size, and the existence of an independent audit. No significant association is found between non-financial performance, board size, board composition and organizational age with the extent of disclosure. This paper contributes to the literature particularly in the context of charity organizations reporting of information through its disclosure in annual returns.

**Keywords**—charity organizations, disclosure, organizational attributes.

## I. INTRODUCTION

A CONSIDERABLE amount of literature has examines the association between organizational specific attributes and the extent of disclosure in charity annual returns (see, for example, [1-4]). The most distinctive methodology employed is the construction of a country-relevant disclosure index and to relate the quantity of information disclosed to organizational-specific attributes. Depending on the research objective and the country regulatory policy on disclosure, the index comprises of mandatory information items and/or mandatory items. Disclosure measurement may be either weighted or unweighted. The determination of weight is

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usually based on the perceived relative importance of selected items by a stakeholder group [5, 6]. Alternatively, an unweighted index disclosure scores each item equally [5, 7-9]. The purpose of applying an unweighted, i.e. presence or absence (dichotomous) index is to reduce subjectivity in determining weights. This approach become is a norm in annual report studies [10].

Previous studies have proven that disclosure of information is an essential element in donations decision. Academic researchers and policy makers have recognized that donations as a part of the responsibilities to society [11]. The responsibility to society is known as corporate social responsibility (CSR). Previous studies that indicated corporate donations as an indication of social responsibility include [12, 13] and as special class of CSR [14]. This social responsibility initiative does not only applied to the corporate sector but also extended to the government-linked companies [15]. This paper further extends the application of social responsibility in the annual returns reporting of charity organizations. It contributes to the literature particularly in the context of charity organizations reporting of information through its disclosure in annual returns. The findings of this paper also provide meaningful insights to the regulatory and the stakeholders about the extent of information disclosure and the association of the organizational-specific attributes on the extent of disclosure.

The remainder of this paper is organized as follows. Section II reviews the literature on the extent of disclosures. Section III outlines the hypotheses development. Section IV describes the data collection and research design. Section V summarizes the findings and finally, Section VI discusses the implications and concludes the study.

## II. REVIEW OF LITERATURE

### A. Financial Reporting Environment of Charity Organizations in Malaysia

The primary objective of financial reporting is to provide information that is useful for resource providers in making rational decisions about the allocation of scarce resources to business and non-profit organizations (NPOs) [16, para. 35]. From the social perspective, accountability implies a

willingness to endure public scrutiny and a duty to report not only the minimum requirement of the law [17]. The annual report produced by most organizations is one measure to fulfil their accountability duty to their stakeholders and to the society at large. Reporting is a means of accountability tailored to meet the stakeholders' information needs, as highlighted in the Malaysian Accounting Standards Board [18, para. 7] that states:

*“Financial statements are a structured representation of the financial position and financial performance of an entity. The objective of general purpose financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. Financial statements also show the results of management’s stewardship of the resources entrusted to it.”*

The main statutes dealing with establishment and regulation of NPOs in Malaysia are the Societies Act 1966 (Act 335) & Regulations and the Income Tax Act (ITA) 1967 issued by the Inland Revenue Department (IRD). Some NPOs may register under specific acts (e.g. the Sports Commission Act or the University and University Colleges Act 1971). The Registry of Society's (ROS)'s primary function is only concerned with the registration, control and monitoring of registered societies throughout Malaysia so that they do not adversely affect the security, peace, public order, welfare or morality in Malaysia. The ROS requires the registered societies to submit Form 9 within 60 days after holding its Annual General Meeting (AGM).<sup>1</sup> In dealing with the accountability and accounting, the registered societies are required to submit the accounts of the last financial year together with a balance sheet showing the financial position at the close of the last financial year of the society. The accounts can either be audited by the societies' internal auditor or an external auditor. For tax exemption purposes, NPOs must formally apply for tax exemptions under Section 44(6) of the ITA 1967 and attach relevant documents, including the audited financial statements.

Based on the above reporting environment of charity organizations, the only primary source of information for stakeholders to make decision is the annual return furnished to the ROS every year. However, the annual returns are limited to the members of the organizations and are not publicly available for reviews. Thus, the current forms of disclosure are very minimal based on the reporting requirements of the regulator. Furthermore, the presentation of the account is not tailored to the stakeholders' needs of information. For this reason, the aim of this paper is to examine the extent of information disclosure by charity organizations and examine the association between organizational-specific attributes with the extent of disclosure.

### *B. Financial Information and the Extent of Disclosure*

Disclosure of information by NPOs is crucial for several reasons. First, information can be used by stakeholders to

evaluate the effectiveness and efficiency of a charity organization. Second, the disclosures can potentially improve donors' perceptions. The donations increase if donors gain assurances of effectiveness are disclosed in the report.

There has been extensive research on non-profits disclosure studies in the developed countries. See for example, in the USA- [19], [20], [21], [3], [22] and in the UK - [23]. Ample research has examined the disclosure levels and financial performance of charity (donations as a proxy of financial performance). A number of studies have found a positive relationship between the extent of disclosure and the amount of future donations received [3, 19-21, 23]. These studies used the extent of voluntary disclosures based on annual reports that are hypothesized to impact the charity donation decisions. In other studies, NPOs websites have been found to be more effective tool in providing financial and performance disclosure for the stakeholders' in making decision [9, 24]. Research indicates that institutional funders, governmental grantors and corporate donors have studied nonprofits' financial statements during grant review process or donation decisions [25]. Nevertheless, many individual contributors do not review a charity's financial statements before making their contribution decisions [26].

Total income has been widely used as one of the charities' attributes in disclosure studies. Total income generated by charity organizations depends on contributed income such as donations from donors and grants from foundations. This shows that financial information reported in the financial statement is important information. The financial information provided by charity can be one of the factors affecting the extent of disclosure and consequently influences a potential donor's decision to donate. Previous studies provide evidence that financial reports play a role in donation decision [27-31].

Through financial reports issued by the charity organizations, donors can obtain necessary information to assess and evaluate the performance efficiency of the organization. Performance efficiency is often used in disclosure studies and proved to affect the charity donations positively [32-34]. Efficiency is defined by [20] as the degree to which non-profit organizations direct their available resources to the organization's mission. This aspect of performance efficiency becomes one of the donors' principal financial concerns to determine the degree to which available resources are directed to providing programs based on donors-specified terms and purposes. [28] and [29] reported that donors' principal concern is the performance efficiency in terms of the percentage of expenses dedicated to programs. In other words, donors want information on whether funds donated are actually utilized for their intended activities and programs that will induce them to donate in the future.

The disclosures beyond financial information are considered as supplemental disclosures of non-financial information. Non-financial information through Service Efforts and Accomplishments (SEA) disclosures are to complement and supplement the financial information. It is also a way to provide information about an organization's mission's

<sup>1</sup> Section 14(1) of the Societies Act 1966 (Act 335) & Regulations

accomplishment. Supplementing information with SEA information was significantly found to have increased the donors' perception towards the charity organizations and increase the percentage of potential donors to donate to the charity organization in the future [35]. [5] examine 100 public and private institutions on their extent of SEA information and found that public institutions are more likely to include performance indicators in their annual reports. Further, public non-profit institutions audited by state auditors rather than certified public accounting firms are more inclined to disclose more SEA information. The Financial Accounting Standards Board (FASB) and the Government Accounting Standards Board (GASB) discuss the reporting of SEA in their conceptual framework [36] to mandate disclosure of performance indicators. Without mandated disclosure, reports containing SEA information have little consistency in their contents. GASB [37] takes a normative approach in producing external reports of *Reporting Performance Information: Suggested Criteria for Effective Communication*. This report suggests the use of 16 criteria in order to communicate relevant, reliable information about the government programs and services to the users of the report.

### III. HYPOTHESES DEVELOPMENT

In this section, we present the hypotheses development on the extent of disclosure in this paper.

#### A. Financial Performance

A charity organization depends on contributed income such as donations from donors and grants from foundations. This shows that disclosure of financial information in the financial statements is very important since it can influence a potential donor's decision to donate. Previous studies provide evidence that financial reports play a significant role in donation decision [27-31]. Through financial reports issued by the charity organizations, donors can obtain necessary information for them to assess and evaluate the performance efficiency of the organization. Therefore, it is hypothesized that:

**H<sub>1</sub>:** *Financial performance of charity is positively associated with its extent of information disclosure.*

#### B. Non-Financial Performance

With the lack of profit as bottom line performance measures in non-profits, a variety of criteria of performance measurement have been employed as non-financial performance measurement. The non-financial performance measurements are also complementing the limitations of financial performance as recommended in the Balanced Score Card performance assessment [38]. Non-financial performance measures are very relevant because these measures are better indicators in evaluating and motivating managerial performance [39]. With the aim to include non-financial performance measurement in relation to efficiency and effectiveness [40, 41] in non-profit setting, particularly on organizational learning practices, [42] identifies five non-financial performance indicators which are: (i) clients' satisfaction on programs or services, (ii) program and

service's efficiency, (iii) increase in clients, (iv) program and service's quality, and (v) overall program and service's effectiveness and implementation. Empirical evidence of his study reveals that performance of the organization is also caused by the organizational learning practices which have a strong positive relationship with performance. Accordingly, this study hypothesized that:

**H<sub>2</sub>:** *Non-financial performance of charity is positively associated with its extent of information disclosure.*

#### C. Board Size

Governance structure, particularly board governance is another important variable that links to information disclosure. Board size has been extensively used as a proxy to measure board governance. A number of studies (see for example, [43], [44], [45]) provide empirical evidence that support the positive association between board size and information disclosure. [46]'s study proposes that as more members are added to the board, there are better levels of monitoring. Larger size of the board of trustees may also be important because of the increased in the levels of fundraising and improved performance. However, opposing evidence was also found in studies relating performance to board size [43, 47] and disclosures to board size [5]. Further empirical investigation is therefore needed. Given the support from the literature of positive relationships, it is hypothesized that:

**H<sub>3</sub>:** *Charity organizations with large board size disclose information to a greater extent than those with small board size.*

#### D. Board Composition

Previous research has shown that having corporate donors on board of charity organizations are related to the organizational efficiency [43] and influence the compliance of the standards [48]. The presence of institutional donors who provide charity organizations with large amount of resources may be interested in the organizational efficiency. They will have more power and access to the information to monitor the organizational efficiency because they demand detailed information beyond the financial information such as detailed strategic plans, budget and information on each project that they financed [49-51]. Nevertheless, some studies proved that having the corporate members on board do not help to guarantee the efficiency of the non-profit organizations [32]. Since studies on board composition consider the relationship between the presence of institutional donors and organizational efficiency, this leads this study to the development of the following hypothesis related to the presence of institutional donors (board composition) and the disclosure of information:

**H<sub>4</sub>:** *The presence of institutional donors on board will be positively related to the extent of information disclosure by charity organizations.*

### E. The Existence of an external audit

The functions of an audit include ensuring the quality of financial accounting and control systems. Given the function of an external audit within the non-profit context, [52] and [53] argued that the existence of the external audit may improve internal control and thus regarded it as an effective monitoring device for improving disclosure quality. They found that the presence of an external audit is significantly related to the adoption of Sarbanes Oxley Act (SOX) disclosure measures. Similarly, [54] provides support that the presence of an external audit minimizes reporting problems and acts as a tool for more reliable financial reporting that enhances disclosure quality [55]. This leads to the following hypothesis:

**H<sub>5</sub>:** *The existence of an independent audit is positively associated with the extent of information disclosure.*

A large number of studies on disclosure attempted to correlate the extent of disclosure with specific control variables attributes of the NPOs. The most frequently examined attributes are organizational size [21, 46, 56] and age of the organization. In this study, the organizational characteristics, i.e. the organizational age and size are considered as control variables.

### F. Organizational Age

The ability to build a strong relationship between the donors and the charity management will contribute to a strong sustainable income for the charity to operate. For this, the organizations need time to establish the donor-relationship [57] for them to survive in the long run. Organizational age may proxy the organizations' ability to establish "a stock of goodwill" between the charity and the donors as mentioned by [31], and [58]. The findings related to the organizational age are found to produce mixed results. Most of the studies report positive and significant results [43, 45, 59, 60]. Nevertheless, there are studies that report no significance between the age and disclosures [19, 24]. This study includes organizational age as a control variable that may influence the extent of disclosure. Following prior studies, organizational age is measured as the natural log of the number of years since registered with the ROS. Consequently, it can be hypothesized that the extent of disclosure might be influenced by the age of the organization. This leads to the following hypothesis:

**H<sub>6</sub>:** *The organizational age is positively associated with the extent of disclosure of information.*

### G. Organizational Size

The organizational size variable has been widely used in previous studies concerning accounting disclosures [5, 21, 24, 61, 62], and numerous studies have persistently relate the organizational size to the financial performance measurement [3, 33, 46, 59, 63, 64]. In most studies, the organizational size has shown a positive association with the extent of annual report disclosure. [61] provided a comparison between the

large and small charities of the British and Irish charities. A comprehensive discussion was made as the reason for the organizational size to be positively associated with the extent of disclosure. They discussed the findings in the context of accountability in terms of conceivable economic incentives for disclosure and provided possible reasons for lower disclosure by Irish charities.

One of the main reasons for larger organizations to disclose more information is because the conscious of the needs of the donors. Donors view the availability of financial information through audited financial statements is important for making donation [3]. Larger organizations are argued to have a better internal reporting. Thus, they have superior information. However, it is also argued that smaller organizations would find disclosure of information is costly and might not find it worthwhile. Recent non-profits studies have found a positive relationship between size and disclosure [5, 21, 24]. Based on the foregoing discussion, this study hypothesizes that the organizational size is positively associated with the extent of disclosure. Accordingly, the following hypothesis is submitted:

**H<sub>7</sub>:** *The size of the organization is positively associated with the extent of disclosure of information.*

## IV. DATA COLLECTION AND RESEARCH DESIGN

The population under study is all registered charity organizations with the ROS in Malaysia and eligible for tax-exempt status. A total of 1,262 registered charity organizations have been granted tax-exempt status under subsection 44(6) of the ITA 1967 as at January 2010. Judgmental or purposive sampling was used in this study to include only the organizations that are willing to participate. As a result, a total of 65 charity organizations formed the sample in this study. The annual returns for the year 2009 of the sample organizations were obtained from the Head Office of the ROS. The age of the establishment of organization in the sample varies from very young group up to the mature group. Majority (62.6%) of them are matured organizations.

### A. Dependent Variable Measures: Extent of Disclosure

Most previous studies on the extent of information disclosure have developed indices to examine the extent of information disclosure with organizational-specific attributes, see for example [65], [66] and [9]. In this study, the extent of disclosure (TDISC) was measured through content analysis using charity disclosure index, developed by the researcher.<sup>2</sup> The index consists of 88 items. Analysis of reliability based on Cronbach alpha was carried out to check the internal consistency of this index. Cronbach alpha of 0.89, surpasses 0.80 to 0.90 indicates the consistency of the index is very good [67]. The index was then checked against the charity organizations annual returns for the year 2009 using content

<sup>2</sup> The sources of information items in the development of the index involve the review of literature, interviews and confirmed by surveys. It is available upon request from the author.

analysis. For each item disclosed, a value of “1” is assigned if the item is disclosed, and “0” otherwise. The disclosure score of each organization was totalled to find out the disclosure score. A charity organization reporting index was then computed by using the following formula:

$$\frac{\text{Total Score of each Organization}}{\text{Maximum Possible Score Obtained by each Organization}} \times 100$$

*B. Independent Variable: Non-Financial Performance Measures*

Studies on NPOs have employed various measurements of non-financial performance measures that include surveys. A comprehensive tool of non-financial performance measurement for NPOs based on five dimensions was developed by [42] in Singapore. His instrument was also validated and tested for reliability. For this reason, his instrument was adopted with permission. Data were gathered through a postal questionnaire survey to the charity management in order to determine the non-financial performance of each organization. The respondents were requested to indicate the relative importance of each item of information on a seven-point likert scale. The purpose of this survey was to determine the charity manager’s perceptions of the non-financial performance attributes of the charity organizations. After three mailings, all 65 charity managers returned the survey resulting in full response rates.

The responses from the last 20 questionnaires returned were compared to the results of the first 20 questionnaires returned in order to check for any non-response bias. This technique, introduced by Oppenheim [68], indicated no significant difference (alpha = 0.05). His instrument was adopted with permission. Data were gathered through a postal questionnaire survey to the charity management in order to determine the non-financial performance of each organization. The respondents were requested to indicate the relative importance of each item of information on a seven-point likert scale. The purpose of this survey was to determine the charity manager’s perceptions of the non-financial performance attributes of the charity organizations. After three mailings, all 65 charity managers returned the survey resulting in full response rates. The responses from the last 20 questionnaires returned were compared to the results of the first 20 questionnaires returned in order to check for any non-response bias. This technique, introduced by Oppenheim [68], indicated no significant difference (alpha = 0.05).

*C. Measurement for Other Independent Variables and Control Variables*

Data on all except one of the independent variables were collected from the annual returns of the participating organizations. Data on the non-financial performance (NFINP) was collected through postal survey. Data on

financial performance (FINP) is measured by natural log of total donations and natural log of board members represents the board size (BSIZE). Further, a binary scheme was used to denote the presence of institutional donors on board (INDB) and the existence of an independent audit (INDAUD). These dummy variables were coded “1” to indicate existence and “0” otherwise. Organizational size (ORGSIZE) is measured by the log of total assets and organizational age (AGE) is measured by the number of inception years.

*D. Regressions Model*

The model estimated for ordinary least squares regression in this study is:

$$\text{TOTDISC} = \beta_0 + \beta_1\text{FINP} + \beta_2\text{NFINP} + \beta_3\text{BSIZE} + \beta_4\text{INDB} + \beta_5\text{INDAUD} + \beta_6\text{AGE} + \beta_7\text{ORGSIZE} + \epsilon$$

where,

- TOTDISC = Overall Extent of Disclosure
- $\beta_0$  = the intercept
- FINP = Financial Performance
- NFINP = Non-Financial Performance
- BSIZE = Board Size
- INDB = Institutional Donors on Board
- INDAUD = Independent Audit
- AGE = Age of Organization
- ORGSIZE = Organizational Size
- $\epsilon$  = Error term

V. FINDINGS

Table I shows the distribution of overall extent of disclosure. The average disclosure was 23.98, with a range of 10 to 39. This result is consistent with the literature that charity organizations have great flexibility in their disclosure [27]. In addition, the relative low disclosure implies that charity organizations in Malaysia may disclose information outside of their annual returns.

**Table I: Descriptive Statistics of Continuous Variables (n=65)**

	Mean	Std. Dev.	Min.	Max.
<b>Dependent Variable:</b>				
TDISC	29.38	6.630	10	39
<b>Independent and Control Variables:</b>				
FINP	11.07	1.520	8	15
NFINP	5.79	0.254	5	6
BSIZE	2.58	0.492	2	4
AGE	3.11	0.792	1	4
ORGSIZE	13.46	2.121	7	18

Multiple regressions were estimated using the organizational-specific attributes as independent variables. The possible existence of multicollinearity was tested in this study. The computation of Variance Inflation Factor (VIF) observed for all independent variables were below 2.0.

Thus, these results support the lack of presence of multicollinearity in the research model. The tests of normality, given the results of the Kolmogorov-Smirnov statistic on the dependent variable suggest symmetrical distribution<sup>3</sup>, thus no violation of the normality assumption. Table II presents the Adjusted R<sup>2</sup> (coefficient of determination), F-ratio, beta coefficients and t-statistics for the model and summarizes the multiple regression results of dependent variable (the extent of disclosure) on the organizational-specific attributes.

**Table II: Multiple Regression Results**

Variables	Coefficient	Std Error	Beta t-values	Sig.
Constant	25.185		1.288	0.203
FINP	0.414	0.518	0.888	0.001*
NFINP	-2.419	3.075	-0.786	0.435
BSIZE	-2.463	1.748	1.409	0.164
INDB	2.237	1.638	1.365	0.178
INDAUD	6.726	1.855	3.626	0.000*
AGE	0.637	1.186	0.537	0.593
ORGSIZE	0.496	0.400	1.239	0.002*

\* significant at 1% level

Three variables entered in the equation were significant at the 0.01 level in the regression model. These variables are: financial performance, existence of independent audit and organizational size. In addition, the directions of the signs of all significant coefficients are in agreement with the hypotheses. In contrast, non-financial performance, board size, institutional donors on board and organizational age are insignificant. Results of Adjusted R<sup>2</sup> indicate that 31.5% of these variables are explained by the variables studied.

The most significant variable is the governance variable; i.e., the existence of independent audit (INDAUD) with a p-value of 0.000. This provides support for Hypothesis 5 (H<sub>5</sub>) that organizations which carried out an external audit are likely to have a higher extent of disclosures. In addition, large organizations tend to have more disclosure (p < 0.01) is supported. This result supports numerous previous empirical studies that large organizations disclose more information because they may have more funding than smaller organizations.

## VI. CONCLUSIONS

In recent years, the regulatory and oversight bodies of NPOs have promulgated non-profits governance in order to enhance accountability and transparency. In Asia, fraud and financial crisis in NPOs have provided more evidence on the governance and transparency issues. There has been little

<sup>3</sup> The value of Kolmogorov-Smirnov statistic has a significant value of 0.2.

research relating to disclosure and specific governance attributes in emerging countries. This study uses Malaysian data to analyze whether the organizations disclosed more information when they performed well, have an external audit and are in size.

There are several important implications of this study. These results provide empirical evidence to attentive Malaysian regulators to improve NPOs transparency by imposing the establishment of an independent audit. It is essential to have a higher accountability to stakeholders via such governance mechanisms. One limitation in this study worth nothing is even though the main focus of this study is on the extent of disclosures, such may not imply quality disclosures due to different instrument used to measure the disclosure. Although the study found the expected relationship between financial performance and governance variable, the findings show that there may be other factors that influence disclosure of information charity organizations.

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