

**ACCOUNTING AND ACCOUNTABILITY IN ISLAMIC
RELIGIOUS ORGANIZATIONS: A CASE STUDY OF
PESANTREN IN THE PROVINCE OF NANGGROE
ACEH DARUSSALAM - INDONESIA**

by

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LIST OF GLOSARIES AND ABBREVIATIONS

- Amanah:** The Arabic term, meaning the trust or responsibility
- Baitul-Mal:** An Islamic institution responsible for the administration and distribution of zakat revenues for disadvantaged Muslims.
- BAZIS:** The abbreviation of Badan Amil Zakat Infaq dan Shadaqah [Zakat Infaq and Sadaqah Collector Board], an organization established in 1968 by the government of Indonesia to manage Zakat, infaq and sadaqah in Indonesia.
- Badan Pembinaan dan Pendidikan Dayah [Dayah Supervisory and Development Agency]:**
A government agency established in 2008, by the government of Nanggroe Aceh Darussalam (NAD) province- Indonesia that primarily responsible for pesantren development in the NAD province.
- Banda Aceh:** The name of the capital city of the NAD province, Indonesia
- Bupati [Regent]:**
The head of Kabupaten [District] in Indonesia.
- BRR:** The abbreviation of Badan Rehabilitasi dan Rekonstruksi [Rehabilitation and Reconstruction Board], the organization established on April 16, 2005 by Indonesian government to implement Aceh and Nias post-tsunami reconstruction.
- BOS:** The abbreviation of “biaya operasioanal sekolah”, refers to special financial aid from government agencies such as from Department of Religious Affair to cover operating cost of schools
- Dayah :** Acehnese term for Islamic boarding school. The name of Dayah come from the Arabic word “Zawiyah” which literally means a corner, which was believed by the Acehnese to have been first used for the corner of the mosque of Madinah where Prophet Muhammad taught the people. This zawiyah word is pronounced as Dayah by Acehnese. In spite of this, the term of pesantren is now more popular and commonly used by the people in the province of Nanggroe Aceh Darussalam.
- Fiqh:** An Arabic term meaning "deep understanding" or "full comprehension". Technically it refers to the science of Islamic law extracted from detailed Islamic sources (which are studied in the principles of Islamic jurisprudence).
- Haram:** The Arabic term, meaning “forbidden”. In Islam it is used to refer to anything that is prohibited by the faith.

- Haj:** A pilgrimage to Mecca during the month of Dhu'l Hijja, made as an objective of the religious life of a Muslim
- Hesab:** In its generic sense, relating to one's obligation to "account" to God on all matters pertaining to human endeavor, for which every Muslim is accountable.
- Hijab:** The Arabic term, frequently used in Malaysia, refers to the dress worn by Muslim women that cover hair and neck.
- Infaq:** An Arabic word meaning charity simply to please God without asking for any favor
- Kitab:** An Indonesianised Arabic word, meaning book. In Bahasa Indonesia, the meaning changes to religious books, e.g. Kitab kuning, Kitab Al Qur'an etc.
- Kitab kuning:** Classical Islamic texts book written in Arabic. Called kuning, yellow, after the tint paper of books brought from middle East in the early twentieth.
- Kyai:** An Indonesian "Jawa" term indicating an Islamic scholar, teacher and leader of pesantren. Kyai is always male.
- Khalafi:** An Indonesianised Arabic word indicating something modern.
- Khalifah:** The Arabic word, meaning successor or substitute. It is used in the Qur'an to establish Adam role as representative of Allah on earth. The more general meaning of khalifah refers to the successor of Prophet Muhammad.
- Madrasah:** An Arabic word, literally, a place of learning, in Indonesia this term means an Islamic school.
- Madrasah Tsanawiyah:**
The term used referred Islamic junior high school
- Madrasah A'liyah:**
The term used referred to Islamic senior high school
- Mudir:** An Indonesianised Arabic Word, meaning the top leader of Pesantren.
- Mufti:** A Muslim legal expert and adviser on the Islamic law.
- Nahwu:** A subject: Arabic grammar
- Nash:** An Indonesianised Arabic word indicating sources from Qur'an and Sunnah.

- NAD:** The abbreviation of Nanggroe Aceh Darussalam referred to the name of one of the province in Indonesia. This province is the only part of Indonesia which has the legal right to apply Islamic law.
- NPOs:** The abbreviation of non profit organizations
- NGO:** Non governmental organization
- Perkumpulan:** The Indonesian term of association, referred to a type of legal entity for non profit exists in Indonesia.
- Pesantren:** The word referred to the name of traditional Islamic boarding school operating in Indonesia. There has been a controversy about the origin of pesantren in Indonesia. However the speculation tend to say that the origin of pesantren has very strong relationship with educational institution that existed prior to the arrival of Islam in Indonesia. It was then continued through the process of adjustment and changed.
- PBUH:** The abbreviation of peace be upon him, a phrase that practicing Muslim often say after saying or hearing the name of prophet of Islam
- Riba:** Literally means 'to grow; to increase.' Technically, it denotes the amount that a lender receives from a borrower at a fixed rate in excess of the principal. It is of two kinds:
1. Riba Nasi'a - taking interest on loaned money.
 2. Riba Fadal - taking something of superior quality in exchange for giving less of the same kind of thing of poorer quality
- Sadaqah:** Donation to others only to please Allah and to get His nearness .Any kind of help which you give to others in cash or in any form is an act of sadaqah.
- Shalat:** The second pillar of Islam, it is a prescribed liturgy performed five times a day and oriented toward Mecca
- Santri:** A pesantren student
- Saraf:** Arabic morphology
- Sirah:** The Arabic term used to the various traditional Muslim biographies, and it was first used in the literature for the biography of the Prophet Muhammad.
- Shari'ah:** The Arabic term meaning the Islamic law. It is a comprehensive code of life regulating the entire spiritual and material life of Muslim.
- Sunnah:** The Arabic word, lexically, means road or practice. In hadith terminology it denotes any saying, action, approval, or attribute whether physical or moral ascribed to the Prophet, whether before or after the beginning of his prophethood.

- Sahabah:** Refers to some one who saw the Prophet Muhammad PBUH and believed in him as well as died as Muslim
- Salafi:** An Indonesianised Arabic word indicating something traditional.
- Tengku:** The title given to religious leaders, e.g. Leader of Mosque, Leader of pesantren. Tengku is always male.
- Ulama:** An Indonesianised Arabic word, meaning Muslim scholars
- Umma:** The Muslim community.
- Ustad:** An Indonesianised Arabic word, meaning a male teacher
- Waqaf:** The Arabic term. It is an Islamic endowment, literally means hold, confinement or prohibition. This word is used in Islam in the meaning of holding certain property and preserving it for the confined benefit of certain philanthropy and prohibiting any used or disposition of it outside that specific objective.
- Yayasan:** The Indonesian term of foundation, referred to a type of legal entity for non profit organization exists in Indonesia.
- Zakat:** Arabic word (almsgiving), it is one of the five pillars of Islam and it is an obligatory payment made once a year under Islamic law which is used for charity and religious purposes.

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PERAKAUNAN DAN AKAUNTABILITI ORGANISASI ISLAM: KAJIAN KES PESANTREN DI WILAYAH NANGGROE ACEH DARUSSALAM, INDONESIA

ABSTRAK

Kajian ini meneliti persepsi Sarjana Muslim mengenai bagaimana sesebuah organisasi Islam mendemonstrasikan akauntabiliti kewangan mereka dan peranan laporan kewangan dalam meningkatkan akauntabiliti, serta praktis perakaunan dan akauntabiliti di sebuah pesantren yang terpilih di daerah Nanggroe Aceh Darussalam (NAD), Indonesia. Kajian ini menggunakan kaedah kualitatif di mana data secara umumnya diperolehi daripada temu bual berbentuk separa-struktur, semakan dokumentasi yang berkaitan dan juga pemerhatian aktiviti seharian di pesantren.

Hasil daripada temubual bersama para sarjana Muslim mendapati bahawa, terdapat kerisauan dalam praktis perakaunan dan akauntabiliti di organisasi-organisasi Islam. Majoriti sarjana Islam yang ditemubual menyatakan bahawa organisasi-organisasi Islam mempunyai kewajipan untuk bertanggungjawab kepada masyarakat, seperti pemberi sedekah, penerima dan juga kepada Tuhan. Mereka menekankan bahawa akauntabiliti di dalam Islam difahami dalam konteks yang lebih luas daripada apa yang difahami secara konvensional, di mana ia tidak mengambilkira hubungan luar daripada masyarakat. Ini dengan secara jelas dinyatakan bahawa aktiviti perakaunan dan akauntabiliti memainkan peranan yang penting semasa sejarah Islam dan aktiviti-aktiviti tersebut adalah sebahagian daripada aktiviti keagamaan kerana Islam tidak membezakan di antara aktiviti keagamaan dan aktiviti keduniaan.

Dalam konteks kes organisasi kajian, pengurusan Pasantren “Peace” melihat laporan kewangan sebagai satu instrumen yang mempunyai peranan yang sangat penting dalam meningkatkan akauntabiliti, dan aktiviti perakaunan dilihat sebagai aktiviti yang tidak bertentangan dengan misi *pesantren*. Walau bagaimanapun, tanggapan umum mengenai aktiviti perakaunan di kes organisasi ini kurang dibangunkan dan hanya memfokuskan kepada pengawalan penerimaan dan pengeluaran dana yang hanya dilaporkan melalui penyediaan laporan-laporan bulanan dan tahunan pengeluaran dan penerimaan, dimana, kebanyakan hanya digunakan untuk tujuan akauntabiliti sahaja. Tiada laporan kewangan gabungan yang dihasilkan yang menggambarkan keadaan kewangan organisasi secara keseluruhan. Pengurusan dan kakitangan organisasi tersebut melihat bahawa mereka bertanggungjawab terhadap tiga tahap “stakeholder”, dimana secara asasnya terdiri daripada *menaik*, *mendatar* dan *menurun*. Tambahan pula, kes organisasi ini juga mengakui Tuhan dalam hubungan akauntabiliti. Walaupun demikian, kesanggupan kes organisasi ini dalam menerapkan akauntabiliti kepada “stakeholder” tidak terlepas daripada penguatkuasaan pihak-pihak lain.

ACCOUNTING AND ACCOUNTABILITY IN ISLAMIC RELIGIOUS ORGANIZATIONS: A CASE STUDY OF PESANTREN IN THE PROVINCE OF NANGGROE ACEH DARUSSALAM - INDONESIA

ABSTRACT

This study concerns the perceptions of Muslim scholars regarding how the Islamic religious organizations demonstrate their financial accountability and the role of financial reporting in enhancing such accountability, as well as the practice of accounting and accountability in a selected *pesantren* in the Nanggroe Aceh Darussalam (NAD) province, Indonesia. The study takes a qualitative approach in which the data is mainly derived from semi-structured interviews and relevant documentary materials as well as observation of the *pesantren* daily life.

The findings suggest that the “Muslim scholars” interviewed have concerns regarding accounting and accountability practices in Islamic religious organizations. The majority of Muslim scholars interviewed pointed out that Islamic religious organizations have an obligation to be accountable to society, such as to the donors and their beneficiaries and to God as well. They emphasize that accountability in Islam is understood as being broader than what is generally understood in conventional accountability, which is not deemed to extend beyond human society. It is clearly stated that accounting and accountability activities play a very significant role in Islamic history and that they are part of the sacred activities, as the division between religious and secular is unknown in Islam.

In the context of case organization, the management of Pesantren Peace views the financial report as an instrument that plays a very significant role in enhancing accountability, and that accounting activities are viewed as activities that

have no contradiction with the *pesantren* mission. However, accounting practices in the case organization are less developed and only focuses on the control of receipts and the disbursement of funds through providing monthly and annual cash receipts and cash disbursement reports, which are mainly used for accountability purposes. There is no consolidated financial report provided to picture the organization's overall financial condition. The management and their staff see themselves as accountable to three levels of stakeholders, which are typically upward, lateral, and downward. In addition, this case organization also recognizes God in the accountability relationship. However, the willingness of this case organization to demonstrate its accountability to its stakeholders is not free from the enforcement of other parties.

CHAPTER 1

INTRODUCTION

This chapter describes the background and objectives of the study. It begins with a brief discussion of the role of accounting and accountability practices in non-profit organizations, particularly, religious organizations and how they lead to the current study. Then, the problem statement is presented followed by the objectives of the study, a brief explanation of the research questions and contributions of the research to theory and practice. Finally, this chapter provides an outline of the contents of the remainder of the thesis.

1.1 Background of the Study

Over the last 20 years, non-profit organizations (NPOs)¹ have become important providers of social services in many countries. Of the several million NPOs in existence, an increasing number of organizations define themselves as religious, spiritual, or faith-based NPOs (see Berger, 2003). The scope, scale and range of non-profit organizations activities focus not only on the traditional domain of charity but include other services such as job training, community and economic development, housing, substance abuse programmes, refugee placement, and others. Examples of such organizations are the Salvation Army, World Vision, and Catholic Relief Services, which, together, enjoyed a combined annual revenue of over US\$1.6 billion and claimed an outreach of nearly 150 million in 2001 (Berger, 2003). Major sources of these non-profit organizations' funding come from membership dues,

¹ There are many terms used to describe non-profit organizations (NPOs) such as independent, third sector, voluntary, charitable, philanthropic, social, public benefit, faith-based, tax exempt, non governmental organization or civil society organization (Cameron, 2004). The term used in this thesis is non-profit organization.

grants from government and private donations. Some NPOs depend heavily on governments for their funding. Such dependence on government funding has increased over the years (Hall, 2002).

Similarly, Islamic-based religious organizations play an important role in society, especially, in the Muslim world. In Muslim society, the total amount of philanthropic giving is estimated to range between \$250 million to \$1 trillion annually (see Alterman, Hunter, and Philips, 2005). Clearly, Islamic and other types of religious organizations make up a significant proportion of organizational activities in many countries, and tend to control a sizeable proportion of human, financial and other resources of that society.

In Indonesia, the country with the largest Muslim population, Islamic religious organizations have provided services for society. One of the most important institutions is the *pesantren*, an Islamic boarding school that provides education services at minimal cost to students. Poor Indonesian families who cannot send their children to public schools rely on religious schools or *pesantren*, to provide at least some form of education (Bremer, 2004). Currently, there are 14,656 *pesantrens* (Islamic Boarding Schools) operating in the country (see Directorate of Religious Education and Pesantren, 2005, p. 18).

However, accounting and accountability practices in the religious organizations are not developed and lack proper financial control (Siino, 2004). As such, there has been a call for good accounting and accountability practices in these organizations. Since they are viewed as a public trust, existing for the benefit of society, they are accountable to society for the resources received. The management of religious organizations are argued to be agents of the public whose duties include ensuring the proper functioning of the organization. Furthermore, accountability is

regarded as more important in these organizations because of the various financial scandals and lawsuits involving them. Some examples of fraudulent practices in this type of organization are the theft by leaders of the Episcopal and Baptist churches and improper use of funds by the head of the National Association for the Advancement of Colored People (see Keating and Frumkin, 2001; Hamilton, 2006).

Even though religious organizations make up a significant proportion of organizational activity in many countries and tend to control a sizeable proportion of human, financial and other resources of society, there is still a lack of knowledge about accountability practices. There has been growth in research concerning religious organizations as noted by many researchers (see Laughlin, 1988, 1990; Walker, 2002; Booth, 1993; Rahim and Goddard, 1998; Lewis, 2001, 2006), but there are only a few researches that have directly examined the issues of accounting in religious organizations (Booth, 1993). Most researches in this area have focused on economic and political factors. Only recently, have researchers begun to look at some of the broader, managerial issues of non-profit organizations. Consequently, there is a growing amount of literature on non-profit organizations that attempts to understand accounting and accountability as an organizationally situated practice. However, only a limited number of researchers have examined Islamic religious organizations, especially those that provide education. These types of organization play an important role in society, especially in Indonesia.

In the province of Nanggroe Aceh Darussalam, the only part of Indonesia that has the legal right to apply Islamic law (shari'ah), there are 852 *Dayah* (they are typically called *pesantren* elsewhere in Indonesia) in 2007.² These *pesantrens* are mainly owned by foundations and private owners. As such, their operations mainly

² Sources: The Department of Religious Affairs, Banda Aceh-Indonesia.

depend on public trust. Due to the lack of information regarding financial accountability in these organizations, there seems to be a perception that the majority of *pesantrens* lack transparency and have no accountability to the public, especially their donors.

Thus, the issues regarding research on accounting and accountability in Islamic religious organizations have been generally unexplored in accounting academic literature (see Carmona and Ezzamel 2006). Hence, a study is needed to examine accounting and accountability practices in Islamic religious organizations.

1.2 Statement of the Problem

Literature on accounting and accountability practices in non-profit organizations indicates that accounting and accountability in religious organizations are less developed and that there is a lack of financial control. This is evidenced by a number of examples in which the mechanism of religious non-profit organizations – the collection of resources from donors and its redistribution for charitable purposes – has been misused or misappropriated (see for example, Siino, 2004; Keating and Frumkin, 2001; Hamilton, 2006). However, the abuse of this financial control often occurred without the knowledge of the donor or even of members of the management and staff of the organization itself.

1.3 The Objectives of the Study

The objective of this study is to discuss the views and opinions of Muslim scholars about organizational accountability in Islam and to empirically investigate the phenomenon of the practices of accounting and accountability in one of Islamic religious organizations “*pesantren*” as well as to understand how these practices

relate to the belief systems held by the *pesantren* and organizational aspects of *pesantren*

1.4 Research Questions

This research will seek to answer the following research questions:

1. What are the conventional views of accountability?
2. What are the Muslim scholars' views of accountability and the role of financial reporting in enhancing accountability of Islamic religious organizations?
3. Do *pesantrens* show accountability to their stakeholders?
 - (i) If yes, how and in what way do they show their accountability?
 - (ii) If no, why not?
4. What are the control systems and mechanisms practiced by *pesantren*?
 - (i) How are the funds received from various sources administered?
 - (ii) How are the funds of the organization being spent?

1.5 Contribution of the Study to Theory and Practices

This study will provide an understanding and explanation of the practices of accounting and accountability in *pesantrens*. As such, this study makes a contribution to accounting and accountability research in religious organizations. Since this study is undertaken on *pesantren*, it contributes to much needed literature concerning accounting and accountability research in such organizations. Furthermore, this study contributes to the theory and practice of management accounting in the religious based organizations, especially in Islamic organizations.

As a qualitative research, this study aims to generate or develop theory. Therefore, additional theoretical insights concerning the issues of accounting and accountability in Islamic religious organizations will be obtained. In addition, a better understanding of accounting and accountability practices in religious organizations will be beneficial to practitioners as guidance for implementing good accounting and accountability practices in Islamic religious organizations. Moreover, the result of this study is also expected to contribute to better management and monitoring of *pesantren* by both government and non-profit umbrella organizations through the development of regulations to promote better accounting and accountability practices within Islamic religious organizations.

1.6 The Outline of the Thesis

This thesis is organized into 9 chapters, Chapter One is the introduction. This chapter explains the background of the study and demonstrates the reasons that influence the choice of this topic of study, statement of the problem, the objective of the study, research questions, and contributions of the study as well as the outline of the thesis.

Chapter Two provides a literature review on accounting and accountability in non-profit organizations. It starts with a brief explanation of the nature of non-profit organizations and the increasing demand for accountability in non-profit organizations. It is followed by discussions of the meaning and conventional concept of accountability and the explanations of the principles of accountability in non-profit organizations. This chapter also describes trust and accountability in non-profit organizations as well as competition in the non-profit organization sector. It then proceeds to discuss the government regulations for non-profit organizations in

Indonesia and the role of financial reporting in non-profit organizations accountability. Lastly, this chapter discusses measuring performance of non-profit organizations.

Chapter Three reviews a number of studies of religious organizations. It begins with the nature of religious based organizations. This is followed by a review of the literature concerning the practices of philanthropic institutions within an Islamic context and accounting and accountability in Islam. It then proceeds to discuss previous researches on the accounting and accountability aspect of religious organizations, followed by a discussion of the role of religious organizations in Indonesia. Finally, the chapter provides explanations concerning the brief of *pesantrens*.

Chapter Four discusses the theoretical approaches which are commonly used in corporate governance and accountability researches. It begins with a discussion of the agency theory. This is followed by the stakeholder theory and stewardship theory.

Chapter Five explains the research methodology that was employed for this study. It starts with a discussion of the qualitative approach and the justifications for using interpretive case study research. Subsequently, the research design, techniques for data collection and data analysis within qualitative research are explained. The chapter ends with the justifications for using grounded theory of this research.

Chapter Six presents the data findings that focus on Muslim scholars' views of accountability and the role of financial reporting in enhancing accountability in Islamic religious organizations as well as their related issues. The chapter starts with a discussion concerning good governance and Islam. It then

proceeds to discuss the importance of accountability in religious Islamic organizations. This is followed by a discussion of the role of accounting and financial reporting in enhancing accountability and to whom that the Islamic religious organizations should be accountable. The chapter also examines how accountability should be shown in Islam and the issues pertaining to accountability in the relationship between trust (*amanah*) and accountability as well as descriptions of sacred and secular activities. Finally, concerns regarding the accounting and the accountability practices in *pesantrens* and factors contributing to the unsatisfactory practices of accounting and accountability of *pesantrens* are also discussed in this chapter.

In Chapter Seven, the findings from the case organization are presented. First, a detailed overview of the case organization is provided. This is followed by a description of the management of the case organization. It then proceeds to explain the financial transparency of case organization and its accountability relationship. This chapter also describes the role of accounting in case organization as well as the arrangement of fund received and spent by the organization. The chapter ends with a section explaining the role of the board (foundation committee) in relation to enhancing the accountability of the case organization.

Chapter Eight presents the emergent theoretical insights of the research findings. The chapter begins with a discussion of the core or central phenomenon generated by the study. It then proceeds to discuss the conditioning context, which consists of religious and secular divide, accountability mechanism: to whom and how accountability should be demonstrated, and the implementation of accounting and accountability in Islamic religious organizations.

Chapter Nine offers some conclusions, starting with a recapitulation of the study. The chapter is then continued by presenting the theoretical contributions and practical contributions of the study. The chapter ends with the explanation of limitations of the study and brief suggestions for future researches.

CHAPTER 2

ACCOUNTING AND ACCOUNTABILITY IN NON-PROFIT ORGANIZATIONS

2.0 Introduction

This chapter provides a review of the literature on the topic of accounting and accountability in non-profit organizations. The purpose of this chapter is to gain an understanding of the accounting and accountability concept of non-profit organizations. Various aspects of the concept of accountability and its related topics will be discussed in this chapter. A search of the pertinent literature reveals that several studies have been undertaken to examine accounting and accountability practices in non-profit organizations. It starts with a brief explanation of the nature of non-profit organizations and the increasing demand for accountability in non-profit organizations. This is followed by a discussion of the meanings and conventional concepts of accountability and an explanation of the principles of accountability in non-profit organizations. This chapter also discusses the issues of trust and accountability as well as competition in non-profit organizations. It then proceeds to discuss the government regulations for non-profit organizations in Indonesia and the role of financial reporting in non-profit organizations. Lastly, this chapter discusses measuring the performance of non-profit organizations.

2.1 The Nature of Non-profit Organizations

Non-profit organizations differ from profit organizations in a number of ways. Some of the non-profit organizations carry out activities for the benefit of their members, while others carry out activities for the public benefit. Traditionally,

there are two types of non-profit organizations recognized by civil law; an organization of persons (individuals), typically called an “association” and organizations involving the dedication of material resources, typically called a “foundation” (Simon, 2005, p.12).

A study on global civil society as quoted by Asia Pacific Philanthropy Consortium (2006, p.1) provides the following four structural-operational features that define an organization within the non-profit organizations sector. The features are:

- *Organized*, i.e., they have some structure and regularity to their operations, whether or not they are formally constituted or legally registered. More than legal or formal recognition, this qualification stresses organizational permanence and regularity, reflected in regular meetings, a membership, and legitimate decision-making structures and procedures.
- *Private*, i.e., they are not primarily commercial in purpose and do not distribute profits to a set of directors, stockholders, or managers. While NPOs may generate a surplus from time to time, they must reinvest these resources back into the objectives of their respective organizations.
- *Self-governing*, i.e., they have their own mechanisms for internal governance, they are able to cease operation on their own authority, and are fundamentally in control of their own affairs.
- *Voluntary*, i.e., membership or participation in them is not legally required or otherwise compulsory.

It is argued that these four characteristics encompass both formal and informal, religious and secular, those with paid staff and those staffed entirely by volunteers and organizations performing expressive functions (i.e., advocacy, cultural expression, community organizing, environmental protection, human rights, religion, representation of interests, and political expression) as well as those performing service functions (i.e., provision of health, education and welfare services) (Asia Pacific Philanthropy Consortium, 2006).

Clearly, non-profit organizations exist for the benefit of the community and not for that of the management or their owners. This kind of organization is prohibited from distributing income to a set of directors, managers, individuals or any private shareholders. This is due to the absence of ownership of non-profit organizations themselves. Both management and the board of the organizations are expected to operate as agents in the public's interest in ensuring the proper functioning of the organizations.

2.2 Increasing Demand for Accountability in Non-profit Organizations

The current environment is making increased accountability a fact of life for profit and non-profit organizations alike. The public want to be assured that their investment in both types of organization is being properly managed. This can be seen as a response to the growing number of lawsuits against those organizations resulting from bribery or misuse of resources.

Every non-profit organization operates in society on the basis of public trust to provide some social services. Therefore, it is accountable to society for the resources received from the society. Without doubt, donors are more discerning than ever before. They want to know "where the \$\$ go!" (Campbell, 1998, p.40). Donors today are looking at the relative value of work for each non-profit organization they are thinking about supporting. They are looking critically at the accomplishments of the organizations, and some donors are even scrutinizing accounting documents to determine just how effective and efficient these organizations really are (see, Campbell, 1988; Ensman, 1996).

According to Herman and Renz (1998, p.4) "non-profit organizations (NPOs) are increasingly being required to become more accountable for

demonstrating that they are making a difference and delivering results”. This means there is the perception that most non-profit organizations have not shown their accountability to their stakeholders. Seen from this point of view, the stakeholders have put more emphasis on people or organizations being accountable and for the accountability process to be made more transparent.

The demand for accountability in non-profit organizations has come from the government, third party actors and the media (Lee, 2004). It is argued that with more state funds being disbursed to non-profit organizations, governments will definitely demand higher levels of accountability. Third party actors, such as corruption watchdogs, have also played a significant role in the emergence and emphasis of accountability by non-profit organizations. In addition, the media has reported quite widely on the matters of accountability in non-profit organizations (see Eisenberg, 2005).

The increased demand for accountability of non-profit organizations has come from various stakeholders with sometimes different demands to be satisfied (Mark and Brown, 2001). Donors demand that the non-profit organizations be accountable for the integrity, efficiency, and impact of programmes that they have funded. Beneficiaries press non-profit organizations to live up to their rhetoric about fostering locally-determined development rather than imposing their own priorities. The internal staff expects non-profit organizations to live up to the high purposes that drew their commitment to the enterprise. Partners who non-profit organizations have recruited in their efforts to achieve their goals (such as other non-profit organizations, government agencies, businesses) expect the non-profit organizations to live up to promises they made in forging their partnerships. Even those who are the targets of non-profit organizations demand a kind of accountability from them.

They want to know to whom the non-profit organizations are accountable and for whom the non-profit organizations speak so that they can gauge the force and legitimacy of the claims that these organizations are making against them (Mark and Brown, 2001).

Thus, non-profit organizations have various stakeholders to whom they might owe the accountability. The problems of accountability usually arise because the claims of the various stakeholders are sometimes not necessarily coherently aligned with one another. Consequently, the leaders of the non-profit organizations have to make choices to embrace or resist particular stakeholders and this can have a profound impact on their missions. This, of course, creates difficulty for non-profit organizations since resisting demands for accountability from specific stakeholders can weaken their support. Financiers may withdraw support to non-profit organizations that are seen as unwilling to be accountable for the efficient use of resources. Committed staff can stop working hard if the non-profit organization fails to embody the values and missions that brought them to the organization (Mark and Brown, 2001).

2.3 Meaning and Conventional Concept of Accountability

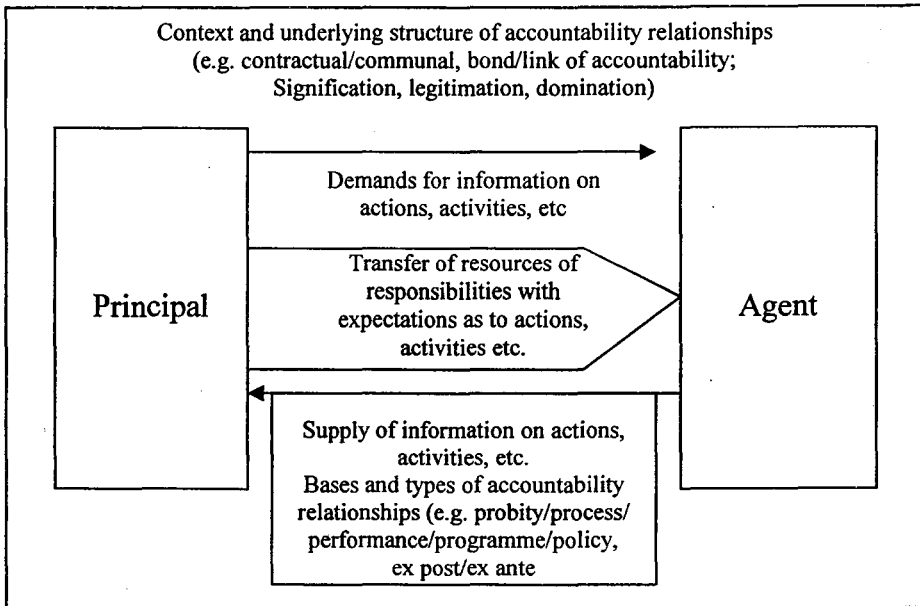
The concept of accountability has attracted considerable research interest in various academic disciplines. Accountability has been used to describe the responsibility of those who manage or control resources to others (Coy and Pratt, 1998). The concept, in general, shows a relationship between two parties in which one party, whether it is an individual, group, company, government, or organization, is directly or indirectly accountable to another party for something, such as an action, process, output, or outcome (Kearns, 1994; Walker, 2002). However, the precise

meaning and implications of this concept are still vague. There are various conceptualizations of accountability, from a literal view that is mainly concerned with reporting activity, to encompassing activities in providing explanation or justification of actions. The concept has sometimes been related to the presence of a contractual relationship between two parties for particular actions. Gray et al., 1987, as quoted by Laughlin (1990, p.96) say that “accountability only occurs when contracts are in existence between principal and agent”. This means that accountability occurs if contracts exist between the one who holds to account and the one who accounts.

Paul (1991) as noted by Kearns (1994, p.186) says that accountability is “holding individuals and organizations responsible for performance measured as objectively as possible”. This definition means an individual or organization being answerable to a higher authority for action taken and for handling resources they received.

A broader definition of accountability is given by Romzek and Dubnick (1987) as quoted by Kearns (1994, p. 187) “accountability involves the means by which public agencies and their workers manage the diverse expectations generated within and outside the organization”. This definition contains elements not found in other previous definitions. It introduces an element of strategy wherein management attempt to forecast diverse expectations and position their agency for proactive as well as reactive response. The managers’ role is transformed from a passive one into one of active participation in framing and articulating the standards by which they are judged.

These two definitions show that there are many important accountability relationships within an organization. In this matter, Laughlin (1990, p.95) illustrates diagrammatically the accountability relationship in Figure 2. 1:



Source: Laughlin (1990, p.95)

Figure 2. 1: Accountability Relationship: A Summarised Picture of Theoretical Insight

This figure shows the relationship involving the giving and demanding that relates to some transference of resources or responsibilities from a principal to an agent with some expectations surrounding the transfer. The expectations are often complex and are either unwritten and implicit or written and explicit. Therefore, Laughlin (1990) divides this accountability relationship into contractual and communal labels. Contractual refers to a more formal context resulting in a written form of recording and defining expectation through a process that involves entering into a legally binding agreement over standards of performance by laying them down in writing and in specific enforceable terms. Whereas, communal accountability encompasses the less formal context and is less structured, expressing stakeholders'

needs through consultation and seeking their involvement in the decision-making process (see Laughlin, 1990; Demirag et al., 2004).

However, Roberts and Scapens (1985) view accountability as a moral order that involves a system of reciprocal rights and obligation. This means that the parties are bound up not only in narrow, calculable ways, but broader than what is generally understood and must serve the moral or spiritual goals of the organization. Seen from this point of view, those in charge of economic resources must give account of their stewardship. Stewardship refers to “a person who manages another’s or financial affairs; one who administers anything as an agent of another or others” (IASB, 2005, p. 2). This stewardship function has been a regular feature of organized human activities from the earliest time. Stewardship and accountability are regarded by some as similar and interchangeable (Lewis, 2006).

2.4 The Principles of Accountability in Non-profit Organizations

The principles of accountability of non-profit organizations are not much different from other organizations. Since accountability is about a relationship that involves the giving and demanding of reasons for conduct in which some individuals, or organizations have certain rights to make demands over the conduct of another as well as seek reasons for the actions taken.

However, there are certain issues pertaining to accountability in non-profit organizations that have received little attention in the accounting literature. According to Gray and Bebbington (2006), those matters relate to issues of size and formality. They argue that regardless of the size of the organization, accountability will naturally occur through some combination of personal contact and the visibility of activities undertaken by the non-profit organization. (If one can, for example, drop

in to a non-profit organization and ask it about its activities then a formal specific account is not required). They further argue that the formal form of accountability could be burdensome on many non-profit organizations, especially the small ones.

Another issue pertaining to non-profit organizations is that there are many stakeholders who do not need formal accountability or who believe that the accountability owed to them is discharged in another manner. Rowl (1972), as quoted by Gray and Bebbington (2006, p. 335), notes that “all relationships involve degrees of closeness it is only in the absence of this closeness that a formal accountability is required”. Non-profit organizations, particularly, grass roots non-profit organizations are the extreme essence of closeness. Much like familial, friendship, neighbourly, and other relationships within civil society, their very essence is one of complex, close interaction. In short, as a general rule, the greater the closeness, the less the need for formal systems.

In addition, it is suggested that the relationship between the organization and the stakeholders, especially their financiers, is not a purely economic one as generating profit is not the objective. It is a more complex relationship and reflects more complex attitudes and interaction between the organization and its various stakeholders. Often the accountability relationship in non-profit organizations may not be, nor need to be, as formal as that between profit oriented institutions and their shareholders. Matters such as trust, social contracts, mutuality and conscience all enter into the accountability relationship of non-profit organizations.

To conclude, the principles of accountability in non-profit organizations can be discharged in many ways, trust sometimes plays a very significant role in this matter. The information can be obtained through an existing channel, mediated either by a close approach or through formal systems of accountability.

2.5 Trust and Accountability in Non-profit Organizations

As Philanthropic institutions, non-profit organizations especially, strongly depend on the public's trust since their major sources of funding come from public donations. The word trust is used to show the attitude of agents towards other agents and it also describes behaviour (Sosis, 2005). Therefore, to trust is to act on the attitude of confidence about another person or group's reliability.

Trust is an important element of charitable giving and is part of all accountability relationships. The significance of trust in an accountability relationship is the fact that the agent may react spontaneously according to the principal's interest rather than responding to contractual obligation and incentive. A lack of trust results in reluctance to take risks in areas like saving and investment (Bekkers, 2003; Seal and Vincent, 1997).

In non-profit religious organizations trust plays an essential role as the resources have to be maintained on the basis of trust rather than the exchange of something tangible such as a goods or services in return. "Muslims are trustees (stewards) for God; Man therefore aggresses to assume this great responsibility in a covenant with God" (Rahim and Goddard, 2003, p.2). Another reason in this accountability relationship is that trust can become a key aspect to create a positive attitude between the agent and the principal.

It is argued that the utilization of a monitoring mechanism undertaken through formal accounting systems could destroy trust (Seal and Vincent, 1997, p.407). They also recognize the existence of low and high levels of trust in organizations. Seen from a control systems point of view, when low levels of trust exist, it will lead to the need for contractual forms of account. Hence, the expectation of the principal can be expressed in more specific terms. Whereas, when the level of

trust is high, “there is no need for contract...the introduction of formal mechanisms such as contracts may displace human linkages and therefore breakdown trust” (Seal and Vincent, 1997, p. 407).

From an accountability point of view, it is likely that the presence of high trust will lead to the use of a communal form of accountability. Nevertheless, it is argued that efficient contracting cannot come about other than in an environment of trust. Therefore, the real task is to determine the empirical circumstance under which formal accounting and contracting processes are compatible with the development of trust and compel the philanthropic organizations to follow a set of a best practices and ethical behaviours to build accountability, transparency and trust (Seal and Vincent, 1997). This is vital; because access to available financial information can help the organizations maintain a good level of accountability and inform the donors about how their donations are used in carrying out their activities. Without access to financial information, as a product of a formal accounting, donors will not be able to make optimal decisions. Accordingly, accounting and formal accountability has become a key component of long-term trust in any relationship.

2.6 Competition in the Non-profit Organization Sector

With over a million non-profit organizations in existence today, there is competition among these organizations for financial resources. People may argue that there is not a market place in the non-profit world due to the absence of a profit motive. However, Leonard (2004, p. 2) says that “wherever goods or services are exchanged, there is a market place in operation”. Those who are involved in an exchange make transactions based on some level of knowledge about the benefits of participating in the “trade”. The greater the knowledge each participant in a

transaction has regarding the potential benefit or making an exchange, the more likely “a trade” will take place. Despite the absence of profit motivation in non-profit organizations, there remains an exchange of donor money for the satisfaction of knowing that those in need have been blessed. With this donation comes a stewardship responsibility of the management of non-profit organizations to both the giver and receiver to see that it has been administered appropriately. Donors will not donate if they believe that their donation will be wasted or misappropriated.

Naturally, donors will ask the non-profit organizations to provide information that enables them to gain assurance that their giving was administered wisely. Leonard (2004, p.2) says that “the market place transaction for non-profits is simply the exchange of money for knowledge that the donation will likely achieve its desired goal of helping those in need”. He argues that failure to satisfy the need of the donors can weaken their support. Donors may withdraw support to non-profit organizations that are seen as unwilling to be accountable for the use of resources. Consequently, it can have a profound impact on a non-profit organization’s mission and operation.

For commercial organizations, customers who buy their products and services confer both legitimacy and financial support. According to Mark and Brown, (2001, p. 11) “the customer’s decision to spend money on the organization’s products and services simultaneously provide a revenue stream that allow organization to remain in operation (support), and provide evidence that the organization is producing something that individuals value (a kind of legitimacy)”. In contrast, the issues of legitimacy and support are more complex for non-profit organizations. To a certain degree, support in the non-profit organization means the same thing that it does in the profit sector, namely, a flow of money and material

resources that allows the organization to stay in operation. However, only a small portion of a non-profit organization's support comes from sales to paying customers. Instead, financial resources of non-profit organizations come from financial contributors – individuals, foundations or governments – who are willing to pay for delivering services to beneficiaries who cannot pay for the services themselves (Mark and Brown, 2001).

Clearly, with today's information about non-profit organizations more readily available, especially through the Internet, donors are able to choose who they fund more carefully. Consequently, non-profit organizations are now operating as serious competitors for societal resources. Financiers now talk about accountability and measuring performance and results. Thus, non-profit organizations are now asked to demonstrate their impact on society and their cost effectiveness. Much of the pressure for this has come from the funding community, consisting of both government and philanthropic sources. Failure to do so will seriously harm their ability to raise funds from private donors. Therefore, to ensure their future survival and produce results, non-profit organizations management must focus, mobilize, and sustain partnerships and coalitions rather than attend exclusively to their own organization.

2.7 Regulations for Non-profit Organizations

In almost every country with an active and growing non-profit organization and philanthropic sector, both the government and the non-profit sector itself have sought ways to strengthen the sector's transparency and accountability. Consequently, the regulation for controlling these kinds of organizations has increased. Experts have argued that the non-profit organizations sector ought to be

similarly controlled to that of profit organizations. Much has been written about the lack of regulation for the non-profit sector. Non-profit organizations are most likely to be unregulated except for control that might be exercised by hierarchies or association groups to which the organization may belong.

Greater transparency and accountability can be achieved through multiple, often simultaneous and overlapping means. National or sub-national (state or provincial) governments can increase direct regulatory focus and enforcement on the sector. Governments can also require or urge the non-profit sector to adopt self-regulatory means to strengthen accountability and transparency, or as a method for collaborating with the government on measures (such as tax exemption) that benefit the sector and society. Also, the non-profit sector itself can adopt self-regulating mechanisms of its own accord, either as a defensive or proactive measure (Sidel, 2003).

In spite of this, no single pattern fits or describes the variety of non-profit self-regulation mechanisms. Since this case study is conducted in one of the non-profit organizations in the province of Nanggroe Aceh Darussalam, Indonesia, this section will review the current regulations of non-profit organizations in Indonesia.

There are two types of legal entities for non-profit organizations that exist in Indonesia, called “yayasan” (foundations) and “perkumpulan” (associations). *Yayasan* was first acknowledged as a legal body during the Dutch colonial time (1870) as non-membership organizations. Most *yayasans* were established under the European legal system, while some adhered to other legal systems such as *wakaf* (donations or grants under Islamic law). Their objectives are normally social, religious educational or humanitarian in nature. *Perkumpulans* are established by a number of people to serve the interests of its members or the public. *Perkumpulans*

are non-membership organizations and established on the basis of membership or a group of people with a common social service objective and not for profit making purposes (Antlöv et al., 2005).

However, facts show that most *yayasans* and *perkumpulans* in Indonesia have been used to illegally accumulate wealth for founders or board members. Antlöv et al., 2005, p. 6) quotes what is stated in the preamble to law 16/2001 as follows:

Facts indicate the tendency of some members of society to establish *yayasan* to take shelter behind the legal status of *yayasan* which are used not only to develop social, religious, humanitarian activities but also to accumulate wealth for the founders, board members and supervisors. Along with this tendency, a number of problems have emerged in relation to *yayasan* activities that are not in line with the purpose and objectives stipulated in its articles of Association and the suspicion that *yayasans* have been used to accommodate illegally gotten wealth of founders or other parties.

Consequently, to restore the function of *yayasan* as a non-profit organization with social, religious and humanitarian goals, and to promote its accountability and transparency, the government of Indonesia established regulations for non-profit organizations as follows:

- The *yayasan* is obligated to issue an annual program and financial reports, by at least placing an announcement in the notice board of the *yayasan's* office (Article 52 Clause 1)
 - A *yayasan* receiving funding from the state, overseas donors or other parties in the amount of Rp500 million (approximately US\$55,000) or more or having assets of more than Rp20 billion (approximately US\$2.2 million) is obligated to publish its financial report in an Indonesian language newspaper (article 52 Clause 2).
 - A *yayasan* receiving funding equal to or more than Rp500 million or having assets amounting to Rp20 billion must be audited by a public accountant (article 52 Clause 3).
 - Annual financial reports of a *yayasan* must be prepared based on the Indonesian Standard of Accountancy (article 52 Clause 5)
- (See, Antlöv, et al., 2005, p.6)

In addition, the Indonesian government has also urged the non-profit sector to adopt self-regulatory means to strengthen accountability and transparency.