

An Empirical Investigation on Annual Reporting Practices of Malaysian State Islamic Religious Councils: Issues and Challenges

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Abstract

This paper aims to evaluate the extent and quality of disclosure of annual report and to investigate in-depth explanation on the obtained evaluation. Specifically, semi-structured interviews are conducted to address the reasons/constraints of such disclosure/non-disclosure and for not preparing an annual report. This study found that there are external and internal problems in preparing annual reports; where it was inferred that the internal problems are more serious. The former consists of lack of enforcement and reporting guidelines, whereas the latter includes attitudes of top management, lack of staff, difficulties in preparing annual reports and transformation of SIRC organisations. However, such a lack of enforcement is the main reason for the inconsistency of the annual report disclosure of some SIRC and its total absence from others. This was highlighted by majority of the interviewees. Despite of those problems, most of the SIRC's accountants claim that they are becoming more active in issuing annual reports. It seems advantageous to address those issues and challenges and SIRC should consider producing a comprehensive annual report for the discharge of their accountability and thus, encourage more funding. They should be more transparent to enhance accessibility, concerning the extent and quality of the disclosure. Consequently, this study was able to make empirical contributions to the literature, and particularly to the practice and knowledge of this type of institutional accounting.

Keywords: *Annual report, disclosure, reasons, State Islamic Religious Councils (SIRC)*

1. Introduction

The history of SIRC's establishment dates back to 1915 when one was established in Kelantan, soon followed by other statesⁱ. The

Federal SIRC is governed directly by the federal government and the remaining thirteen SIRC are under the authority of the respective

states. Each SIRC is established in accordance with the Administration of Muslim Law Enactment in each state, with the state Ruler acting as the head. The constitution delineates the administration of SIRC, autonomous of the state government rather than of the federation, as a statutory administrative structure, capable of exercising power and jurisdictions.

The establishment of SIRC is headed by the respective King to administer Islamic law and to establish a state court system applying Islamic jurisprudenceⁱⁱ. SIRC play charity roles that benefit Muslims and the local community. They are recognised as the highest statutory authority in the state, forming policy for Muslim revenue matters, written in the Ninth Schedule, Federal Constitution. SIRC are responsible for promoting the development of social welfare within the boundaries of Islam. As the SIRC were established in the public service setting, public accountability perspective is pertinent. The public has a right to be fully informed about the performance and condition of the public organisational setting (Coy, Fischer, & Gordon, 2001), this information necessarily satisfying the needs of a broad range of stakeholders. This implies the uniqueness of SIRC, which play social roles in religious-based and public service setting. With this wide range functions, funding for SIRC's operations has become increasingly important. In addition to financial assistance from government, they have other own funding.

Several types of funding characterise the flexibility of SIRC in managing their managerial operations (Siraj, 2012). Despite SIRC being established in accordance with the various state enactments, their main role to increase the well-being of the citizens is challenging, especially as far as financial autonomy is concerned. The financial

capacities of SIRC and the huge responsibilities they have been assigned, place demands for even greater efficiency for all SIRC in the foreseeable future (Mahamood, 2000). Although they are pursuant to the state government, financial provision from the state is limited compared to the federal SIRC. The federal government allocates a financial grant to the federal SIRC as it is governed directly by the Prime Minister's Department, showing that it has financial privilege over other SIRC.

Ministerial Functions Act 1969 (Act 2, amended 1999) declares that statutory bodies have power to lend, borrow, invest, establish subsidiary companies, manage funds and trust accounts, and implement activities and programmes. Although SIRC are entitled to obtain government grants every year, they are nevertheless encouraged to generate their own funds to finance their operations. Such wealth accumulation could enhance them to expedite socio-economic development in their respective states. SIRC are subject to their own incorporation subsidiary legislation that outlines their purpose and powers of autonomy. Mahamood (2000) argues that funding is one of the long-standing constraints for SIRC, preventing them from functioning effectively where the financial resources are not compatible with expected services, consequently affecting their future.

Despite of the limited funding whilst high demand of services from SIRC, they should be held accountable and to be seen accountable to avoid public inquiries on their accountability. A comprehensive annual report could be the best medium to discharge accountability of the reporting entity like SIRC (Masruki, Hussainey, & Aly, 2016). Indeed, this study aims to evaluate the extent and quality of annual reports of SIRC and then, further investigate the reporting practices in relation to the evaluation.

2. Disclosure studies on SIRC

A review of previous studies on SIRC was carried out to identify the area where a contribution to the SIRC context can be made. These are summarised in Table 1 below.

Table 1: Summary of related studies on SIRC

No.	Author/s	Research objective/s	Method/s	Findings
1	Siraj (2012)	to provide insights into the accounting, accountability and effectiveness of SIRC and the management of the <i>waqaf</i> practice.	Interview , questionnaire, document review	Several conspicuous discrepancies in the financial reporting practices among the SIRC populations. The practice lacks accountability expected in public service entities.
2	Yaacob & Nahar (2011)	to investigate accounting, reporting and accountability practices of a Malaysian cash <i>waqaf</i>	Interview	Accountability does exist in the cash <i>waqaf</i> operations of the council studied. A significant improvement is needed to ensure continuous accountability.
3	Hisham (2006)	to investigate the <i>waqaf</i> accounting and administrative practice in the	Document review, interview, observation	No independent detailed information on <i>waqaf</i> in the financial statement.
4	Md. Zain (2005)	to analyse the level of <i>waqaf</i> disclosure	Document review, questionnaire	The SIRC's annual report was not prepared on a regular and punctual basis. There is a low level of disclosure in their annual report due to the absence of qualified accounting staff.
5	Abdul Rahman & Goddard (2003)	to explain accounting as a social practice and to develop an accounting explanation in religious organisations	Interview, document review	Several differences in accounting practices occurred between the organisations within which the studied organisations were located although they had in fact the same religious denomination.
6	Abdul Rahman <i>et al.</i> (1999)	to investigate the accounting system and the administrative style of a <i>waqaf</i> unit	Interview	There is a lack of an accounting system, no detailed information and unsystematic management of the <i>waqaf</i> assets.
7	Abdul Rahman & Goddard (1998)	to examine accounting practices	Interview, document review	Accounting practices in the SIRC demonstrate the existence of a power elite culture.

Based on Table 1, there have been a limited number of studies on the SIRC accounting practices, the majority not published in academic journals. These were conducted for post graduate research such as Ihsan & Adnan (2007), Yaacob (2006) and Siti-Rokayah (2005). This is not the case for other fields of research about SIRC like Islamic jurisprudence, law and management studies. Despite this limitation, there are useful findings, some of which are lack of accountability dimensions, no detailed information, absence of qualified accountants and lack of an accounting system, which may implicate the needs for improvement. This

study attempts to discover these issues via interviews. The previous studies did not examine annual report of SIRC using a disclosure index, perhaps due to the limited feasible annual report earlier than 2008. Only recently has the publication of annual report been demanding, especially in 2007, which marked the introduction of the Accountability Index. It is timely to examine SIRC annual reports to identify current reporting trends. Consequently, this study is the first to contribute to the disclosure study on the SIRC's comprehensive reporting, which might be of interest to religious-based, charities and public service organisations.

3. Methods

This study used both content analysis using disclosure index and interviews. The former was employed to examine the extent and quality of disclosure of annual report of SIRC, whereas the later was to get in-depth explanation on the current state of disclosure within SIRC. This study used both an unweighted and a weighted disclosure index using the five-point Likert scale. Based on the unweighted approach, an item was given '1' if disclosed or otherwise '0'. Then the extent of disclosure was measured by computing the ratio between the SIRC score and its maximum possible score (MPS). The MPS is important to indicate any 'non-applicable item' was not penalized if it had not been disclosed. Meanwhile, according to the weighted approach, standard disclosure was used to measure the extent of disclosure. The result of the mean used to reflect the weighted index for each item represents the arithmetical

average of the score given by the respondents to each of the disclosure items. Both unweighted dichotomies and weighted importance were used in this study to generate the final score of the extent of disclosure for the annual report, performance reporting and the financial statementⁱⁱⁱ. Next, the quality of disclosure was evaluated, based on the predetermined criteria, adapted from Beest, Braam, & Boelens (2009). Each score of the extent and quality of disclosure was normalised as 100% and any irrelevant item was not penalized. The score of extent and quality is added to generate the final score for each report, which is again normalized to 100^{iv}. Next, semi-structure interview was conducted with SIRC accountants (AC), users – auditors (AU) and the public who is actively doing research about SIRC researcher, also cum as contributors (C) as well as Regulators (R).

4. Results and discussions

The first part of this section is a discussion on the evaluation of the extent and quality of disclosure, for scores of annual reports, and for performance reporting and financial statement disclosure. The score is made up of

the extent and quality scores. Table 2 presents descriptive statistics of the scores for annual reports, non-financial and financial statement disclosure.

Table 2: Descriptive statistics of variables

Variables	Mean	Median	SD	Min	Max	Skewness	Kurtosis
Dependent variable (n=72)							
Annual Report	52.20	41.74	15.55	33.31	76.40	0.330	-1.743
Extent	56.79	48.04	15.70	32.17	81.59	0.289	-1.612
Quality	47.61	36.70	15.71	27.80	73.20	0.350	-1.695
Non-financial statement	24.64	0.00	28.99	0.00	68.79	0.374	-1.810
Extent	24.33	0.00	28.63	0.00	66.66	0.373	-1.818
Quality	24.95	0.00	29.53	0.00	70.91	0.408	-1.744
Financial statement	79.76	80.89	4.61	66.61	86.61	-1.479	1.797
Extent	89.24	88.44	6.87	64.34	99.89	-1.418	3.084
Quality	70.28	71.11	4.48	55.56	75.56	-1.903	3.755
Independent variables (n=72)							
Size	7.85	7.89	0.62	6.19	8.71	-1.189	1.684
Liquidity	15.46	8.83	18.58	1.34	89.54	2.604	6.698
Leverage	0.20	0.10	0.26	0.01	1.14	2.136	4.114
Efficiency	0.82	0.84	0.19	0.30	1.20	-0.395	-0.151
Surplus_dummy	0.93	1.00	0.26	0.00	1.00	-3.460	10.255

As reported in Table 2, the mean score of disclosure for financial statement is higher (79.76%) than for the annual report (52.2%). Looking at the components of the annual report, the mean score of the financial statement (79.76%) is much higher than that for non-financial statement items (24.64%)^v. Likewise, the extent and quality scores of disclosures show a similar trend to the final score of the report. In this paper, it is therefore pertinent to investigate the reasons of low level of disclosure on the volunteered non-

financial items as compared to the mandated financial statement. In preparing annual reports, two types of problems were identified, external and internal factors. The former is less significant than the latter as mentioned by two SIRC accountants in the North (AC4 and AC6).

The second part of these findings presents reasons of disclosure and constraints of non-disclosure in SIRC annual reports. Those factors are divided into two; these are: external and internal factors.

4.1 External factors

Lack of enforcement in reporting

When there is no enforcement in the preparation of the annual report, the National Audit Department (NAD) will not take into account the annual report as part of the checklist for auditing. This has contributed to the inconsistency or absence of annual reports, which was highlighted by both an auditor and a researcher (AU2 and R1). “Problems of the absence of annual reports might possibly be resolved if there is enforcement in the provision of enactments in the state government” [AU2]. “Such enforcement drives SIRC to prepare annual reports because they have to do it” [C1]. The enforcement can be driven by either the top management or higher authority. Several accountants mentioned that if the CEO makes an annual report compulsory, the management has to prepare its annual report without needing any additional reasons. One regulator said: “SIRC in federal territory, for instance, are required to prepare an annual report in addition to financial statements; they do it consistently. However, this requirement does not apply to other SIRC” [R1]. This study also found that the annual reports of SIRC1 were prepared

consistently and could be easily accessed on their website, but this was not the case for other SIRC. Furthermore, SIRC2 in the Central region started preparing annual reports in 2005 and have published them consecutively to date; they are also available on its website. Its accountant mentioned that this was due to enforcement from the top management, supporting Daniels *et al.* (2010), which suggest that enforcement is related to high disclosure. In fact, only these two, SIRC1 and SIRC2, had online reporting. This may suggest that both SIRC, which are located in the Central region are more aggressive. This is probably because of their size, with a high collection volume, similar to large charity bodies in the UK (Connolly and Hyndman, 2004). On the other hand, perhaps lack of enforcement might contribute to the absence of annual reports of other SIRC. This indicates that SIRC have treated voluntary disclosure as if it were mandatory, when there is an enforcement of an annual report (Hope, 2003), encouraging the preparation of an annual report.

Lack of reporting guidelines

In Malaysia, there are no accounting guidelines for zakat and waqaf, highlighted by an accountant in SIRC in the East Coast² (AC4). “When we started preparing the annual report in 2008, there were no guidelines or specific format. All departments were instructed to report their undertaken activities, like myself to report financial matters. So, we had no sources to refer to and indeed it is all our own creativity” [AC11]. However, a National Auditor mentioned: “Numerous efforts have been undertaken to prepare specific accounting standards. Lack of agreement from the fatwa in each state, in addition to the different provisions of state enactment has contributed to the difficulties in standardising reporting for SIRC” [AU2]. Such lack of agreement was probably due to the different size of SIRC in terms of collected zakat funds and their needs in a state. SIRC in the Central region, North, East Coast and South has various backgrounds of local fund providers and recipients. Therefore, the most effective practices to deal with the management of a zakat fund are unique and distinct from one SIRC to another. This might influence the fatwa decisions in each state. One regulator (R1) elaborated on the development of the Malaysian Government Treasury Circular (MGTC), guidelines for the preparation and presentation of financial statements and annual reports. The circular refers to MGTC4/1994, which was introduced in 1994. This applies to statutory bodies at federal and state level. In this instance, the federal statutory bodies refer to SIRC in federal territory while other SIRC are positioned under the respective state government. The circular was revised in 2007 as MGTC4/2007 replacing the previous MGTC in 1994. This provision was mentioned in Act 240, Statutory Bodies Act

1980, which indicates that all government agencies are required to prepare financial statements. These financial statements must include five distinct elements, namely: Balance Sheet, Statement of Income and Expenses, Cash Flow Statement, Notes to the Accounts, and Statement of Equity Changes. Given the above explanations, however, it should be noted that only a financial statement is required, but not a comprehensive annual report. In relation to the guidelines, at the federal level, the Prime Minister’s Department i.e. JAWHAR monitors the roles of SIRC. Another regulator (R3) states that JAWHAR does not prepare any specific reporting guidelines for SIRC. However, they do provide a template form to gather data for collection and distribution of zakat, so as to update data in the database in JAWHAR. Remarkably, the uniqueness of SIRC raises conflicts between government reporting requirements, Shariah and public discourse, as illustrated in the following observation: “...being an Islamic institution should lead to different or at least some differences in the reporting system compared to other government bodies because Muslims have to uphold amanah (trust), which in English is termed responsibility and accountability” [C2]. SIRC seem to have difficulties in preparing annual reports, as they are different from other government entities especially in relation to Shariah, besides the sophistication of accounting tasks mentioned by Heijden (2013). They need to have specific guidelines to help them to prepare annual reports to satisfy a wide range of stakeholders. Likewise, Anderson & Findlay (2010) recommends such guidelines in addition to those outlined in the International Public Sector Accounting Standards (IPSAS). However, an accountant in the Central⁴ disagreed, stating they did not

have a problem with the guidelines. He mentioned that although in practice, there are some differences, it is not so distinct from

other government entities in terms of reporting. It merely requires additional information in the reporting.

4.2 Internal factors

Attitudes of top management

An enforcement of reporting from the top management could affect reporting practices. If they are serious about the preparation of an annual report, this will help to resolve its absence. However, the issue now is who the leaders are and to what extent they are aware of the importance of the annual report for discharging SIRC accountability. One SIRC accountant in North2 responded: "Traditionally, the state enactment provides that the top leader of SIRC is also a director in the Department of Islam. He is a civil officer. However, it was amended in 2010. The state Ruler, His Royal Highness, appointed a corporate person as the CEO to lead our SIRC" [AC4]. He further acknowledged that the power of a CEO is great without any political intervention and bureaucracy, especially in distributing the trusted funds.

This implies that a restructuring process has been proven to have influence reporting practices in SIRC. In the case of North4, reporting has improved tremendously after the new leadership style and expectations of the leader. The top management in an SIRC usually consists of corporate people, state mufti, fatwa scholars and top officials in the state government such as state secretary, legal advisor and accountant. Despite the various backgrounds of top management in SIRC, the political agenda is seen to be another factor that might influence reporting practices. If the leader is a political person, they tend to disclose more, which could be in the electronic media, press or both, in order to win more votes from the public (Laswad, Fisher, & Oyelere, 2005).

Lack of staff in SIRC

When the accountants were asked about the absence of an annual report in some years, one of them mentioned the lack of staff. "Prior to 2008, there was only an assistant accountant with no accountant here. After that, only an accountant was appointed and the first accountant improved the annual report like the corporate annual report. I was the second accountant, appointed in 2012" [AC4]. However, an accountant in the South (AC9) denied the inadequacy of staff in preparing annual reports; instead she mentioned the difficulties in preparing an annual report, which needs coordination and cooperation across all departments. An accountant in the North (AC7) highlighted the staffing problems. Initially, employees in SIRC are

appointed by the state government on a contractual basis. When there are staffing warrants from the Department of Public Services (JPA), the status of a job is changed from a temporary to permanent status. Consequently, employees are probably not comfortable with the contract basis of employment, which may contribute to the high staff turnover and the lack of staff in the SIRC. Nevertheless, staffing was not considered to be a problem by a researcher, C1: "They have lacked staff for the last fifteen years. They will lack staff for another 15 years. That's the excuse. JPA has already revised the allocation number of staff in SIRC. It was significant, anyway" [C1]. In that instance, an accountant in the North

mentioned: “Prior to 2000, we had a shortage of staff in the accounting department and we don’t even have an accountant. However, it has changed since then as it attracted the attention of the former Malaysian Prime Minister, Tun Mahathir” [AC6]. The

Difficulties in preparing annual reports

The preparation of an annual report consists of financial and non-financial reports; indeed it does not involve just the finance or accounting department. One SIRC accountant in Central2 mentioned: “The accounting department focuses on the financial statement which should be submitted to the National Audit Department in April every year” [AC2]. He added that most SIRC have subsidiaries and the account should be consolidated. A financial statement is more important than the annual report. Preparing the financial statement is faster and more objective than annual report and the former is mandatory and will be audited. The same reason was also mentioned by another SIRC accountant (AC11) in the East Coast. She mentioned that all departments should get involved; it is not just a financial report. They have to compile non-financial activities and achievements, so it might be difficult to publish. Exclusively financial statements pose no problem, as they should be presented to EXCO in SLA every year. Relating to this point, a SIRC accountant in the South suggested: “The Public Relations Department is a suitable unit to be responsible for preparing an annual report. Cooperation from every department, however, is important to provide information on the financial and non-financial activities undertaken in their departments, the main problem for preparing an annual report. But, since we have an IT department, it could be resolved by establishing a database for activities and programmes undertaken” [AC9].

Nevertheless, databases are also problematic.

responses from interviewees imply that staffing influences their reporting practices, which should be brought to the top management’s attention (Abdul-Rahman and Goddard, 1998).

Another SIRC accountant (AC4) in the North highlighted that there was a challenge in their computer system. They use a self-developed database, which involves zakat assessment and data about zakat distribution. In his example, after distribution of zakat funds has been approved, it will be recorded in the system, namely: e-syura. The IT department is involved in the entire process of application, investigation and approval. The problem raised here is that the developed system could not match the required data, or else some errors occurred in generating the data. Therefore, they had to carry out the recording process manually. This was a problem previously, but it has been steadily improved. Similarly, an SIRC accountant in the East Coast1 also mentioned: “In preparing the annual report, starting from April 2015, we will initiate a new computerised system. The existing computerised system is for zakat, and other funds are separated for different usage. For instance, the fund for amanah is a trusted fund donated by the public or other corporate organisations for a specific reason such as victims of flood and natural disasters” [AC12].

The annual report in East Coast1 has been produced consecutively from 2010 to date. As such, the use of technology is believed to be an important tool in any task (Deakin & Wakefield, 2014). In this case, the preparation of the annual report is encouraged and speeds up the process of recording and generating each department’s report for further compilation. The comprehensive database that

includes financial and non-financial matters is believed to facilitate the preparation of the

annual report so as to reduce a co-ordination problem across departments.

Transformation of SIRC organisations

In some states, SIRC are also known as Baitulmal and have a small number of staff. The roles of the Baitulmal are not obvious, as they are recognised only as one unit under the Department of Islamic Religion in the state. One SIRC accountant in the North claimed: “We are in a transformation process. MAMPU has prepared a strategic plan for us to uphold the roles of SIRC as inspired by his Ruler. As a result, the score accountability index has been improved from time to time” [AC7]. As an annual report covers financial and non-financial information from each department and related organisations, restructuring could result in an intervention of the annual report. Another SIRC accountant in the EastCoast2 clarified that they had not prepared annual reports for the last two years because of the restructuring process. She added: “Our SIRC

is the first state restructuring its organisation” [AC11]. Several religious state departments such as the Department of Islamic Religion, Department of Justice *Shariah*, Department of Mufti, are still undergoing restructuring. She said that her organisation had not received approval from the Department of Public Services to recruit staff. The last annual report was prepared in 2011 and it has not been prepared since then due to the ongoing restructuring. The restructuring was decided following the Congress of Rulers in 2011, which aimed to strengthen religious institutions and combine all Islamic religious institutions under the Royal Highness in each state. This is to facilitate religious dealings where the SIRC is appointed as a policy maker, and other religious departments under SIRC are implementers of SIRC policies.

5. Conclusions

The importance of an annual report is acknowledged in many similar studies of non-profit organisations (NPO), in particular due to the absence of bottom line of profit figure. Despite the lack of disclosure and inconsistency in issuing annual report, all respondents agreed that an annual report should be prepared. A researcher (C1) commented on the constraints of preparing an annual report: “.if we do it efficiently, it is not about the amount of information that we provide. The information could be very basic

for the staff but more importantly, is actually that SIRC should understand their role and responsibility. The way I observed SIRC, they are run like government departments but are really an NPO as well”. He added that if SIRC adopted an appropriate mentality, reporting would come naturally; otherwise, it was just a concrete issue, whether it was enforced or not. Therefore, these findings imply that despite the various internal problems in SIRC, enforcement could mitigate the lack of disclosure.

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ⁱ At present, there are 14 SIRCs, located in each of the 13 states and 1 in the federal territory, formed under the auspices of the government of Malaysia.

ⁱⁱ However, in states with Rulers some statutes require that the Chief Minister advise the *Ruler* whereas others permit the SRCs to provide advice. In fact there are still some states, which do not provide clearly for any person to advise the *Ruler*. There is indeed a lack of uniformity in the SRC management structure.

ⁱⁱⁱ While thirty-one annual reports were used to evaluate the extent and quality of non-financial statement items, this also applied to seventy-two financial statements.

^{iv} As for the regression purpose in Section 8.4, despite the absence of annual reports, the non-financial statement items were scored zero, to compute the final score of disclosure for each SIRC, in addition to the

scores of the financial statements. Therefore, the total number of observations is seventy-two i.e. from twelve SIRC over six years.

^v In this study, as for the sampled SIRC' annual reports (n=31), non-financial statement items will be investigated further while the financial statements are included in the entire financial statement variable (n=72).