FINANCIAL SUSTAINABILITY OF COMPANY LIMITED BY GUARANTEE CHARITIES IN MALAYSIA

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2020

FINANCIAL SUSTAINABILITY OF COMPANY LIMITED BY GUARANTEE CHARITIES IN MALAYSIA

by

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Thesis submitted in fulfilment of the requirements for the degree of Doctor of Philosophy

November 2020

ACKNOWLEDGEMENT

I would like to express my deepest gratitude to my main supervisor, Dr Phua Lian Kee, and co-supervisor, Professor Dr Siti Nabiha Abdul Khalid, for their immense patience and firm guidance throughout this PhD journey.

I am grateful to all my family members and friends who have supported me along the way.

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KELESTARIAN KEWANGAN BADAN AMAL SYARIKAT BERHAD MENURUT JAMINAN DI MALAYSIA

ABSTRAK

Badan amal bersaiz besar atau kecil memainkan peranan penting dalam menjaga kebajikan sosial dan memberi pendidikan kepada masyarakat. Kini, mereka dilihat sebagai penyumbang penting pertumbuhan ekonomi dan infrastruktur sosial; mereka juga majikan dan pembekal perkhidmatan yang besar. Namun, kegagalan badan amal telah menjadi masalah yang melanda kedua-dua negara maju dan negara membangun. Di Malaysia, dilaporkan bahawa badan amal mengalami kesulitan dalam mengumpulkan sumbangan oleh sebab ketidakstabilan keadaan ekonomi. Oleh itu, tujuan kajian ini adalah untuk menentukan tahap kelestarian kewangan semasa badan amal, serta mengetahui hubungan antara akauntabiliti, penjanaan pendapatan sendiri, kepelbagaian pendapatan, kepelbagaian tempoh pengarah, keupayaan pengurusan kewangan dan saiz organisasi, dan bagaimana hubungan-hubungan tersebut membawa kepada kelestarian kewangan demi membentuk kerangka teori kajian ini. Teori pengurusan dan teori kebergantungan sumber menerangkan kerangka ini dengan merujuk kepada tindakan dan keputusan para pengarah untuk memperoleh, mengurus dan mengendali sumber (melalui faktor kepelbagaian tempoh pengarah, kepelbagaian hasil dan penjanaan pendapatan sendiri) serta untuk mempraktikkan pengurusan yang bertanggungjawab (melalui faktor akauntabiliti dan keupayaan pengurusan kewangan) dalam usaha mereka untuk mencapai kelestarian kewangan. Kajian ini menerapkan *Structural Equation Modeling* (SEM) untuk menguji kerangka mendapati bahawa saiz organisasi dan kepelbagaian pendapatan merupakan peramal langsung kelestarian kewangan;

sementara akauntabiliti dan keupayaan pengurusan kewangan kedua-duanya mempunyai hubungan tidak langsung yang positif dan signifikan dengan kelestarian kewangan melalui faktor pengantara kepelbagaian pendapatan, penjanaan pendapatan sendiri dan saiz organisasi. Penemuan kajian ini menyumbang ke arah satu model kelestarian kewangan badan amal yang telah diuji dan disahkan, yang selanjutnya digunakan untuk membangun indeks penilai kelestarian jangka panjang badan amal tertentu. Implikasi kajian adalah seperti berikut. Pertama, oleh sebab saiz badan amal mempunyai pengaruh positif terhadap kelestarian kewangan, saiz organisasi yang besar ialah situasi yang ideal kerana mempunyai sumber yang mencukupi untuk digunakan. Kedua, kepelbagaian tempoh pengarah yang kurang di seluruh populasi badan amal mempunyai implikasi bahawa perlunya polisi penyegaran lembaga pengarah, selaras dengan cadangan tadbir urus korporat umum. Ketiga, badan amal harus berusaha untuk merekrut pengarah dengan kelayakan perakaunan profesional sebagai petunjuk kemahiran dan kecekapan kewangan yang boleh dipercayai. Akhirnya, lebih peruntukan berkaitan dengan tadbir urus disarankan dalam undang-undang dan polisi badan amal serta sektor ketiga secara umumnya.

FINANCIAL SUSTAINABILITY OF COMPANY LIMITED BY GUARANTEE CHARITIES IN MALAYSIA

ABSTRACT

Charities of all sizes play an essential role in society and economy, and provide social care and education, and they are now increasingly viewed as critical contributors to economic growth and social infrastructure; they also represent a substantial employer and a provider of services. Yet, charity failure has been a problem that has been plaguing developed countries and developing alike. In Malaysia, it has been reported that charities have difficulties in raising donations due to the difficult economic climate. In view of the foregoing, the purpose of this study is to determine the current level of charity financial sustainability, and to discover the relationships amongst accountability, own income generation, revenue diversification, director tenure diversity, financial management capacity and organisation size, and how these relate to financial sustainability; the latter forms the theoretical framework of this study. Stewardship and resource dependency theories explain this framework by reference to the actions and decisions of the directors to obtain, manage and control resources (via director tenure diversity, revenue diversification and own income generation) and to practise responsible stewardship (via accountability and financial management capacity) in their effort to attain charity financial sustainability. This study applied the Structural Equation Modelling (SEM) to test the framework, utilising the *lavaan* package version 0.6-4 in R version 3.6.1. The study found that organisation size and revenue diversification were direct predictors of financial sustainability; while accountability and financial management capacity both have significant positive indirect relationships with financial sustainability via intervening variables revenue diversification, own income generation and organisation size. The findings of this study serve to contribute towards a tested and confirmed model of charity financial sustainability, which can then be further utilised to develop an index to rate the long-term sustainability of a particular charity. The study has the following implications. Firstly, as charity size has a positive influence on financial sustainability, a large organisation is an ideal situation as it implies having adequate resources to draw upon. Secondly, the poor variability of director tenure diversity across the charity population implies the need for charities to establish a board refreshment policy, in line with general corporate governance recommendations. Thirdly, charities should endeavour to recruit directors with accounting professional qualifications as it is a reliable indication of financial skills and competence. Lastly, more governance-related provisions in the laws and policies pertaining to charities and the third sector in general are recommended.

CHAPTER 1

INTRODUCTION

1.1. Background

Charities are organisations that are established for the sole purpose of providing public benefit. They form part of the third sector (the sector that is neither public nor private), which is independent of the government, value-driven and generally reinvest any surpluses generated in the pursuit of stated goals. The third sector comprises voluntary organisations, community organisations and not-for-personal profit organisations. Such organisations can be legally structured via different ways: they can be societies or associations, companies limited by guarantee, co-operatives and social enterprises.

The impact of charities can be categorised into five domains (Simsa, Rausher, Schbober and Moder, 2014): provision of human services; social innovation and change; civic engagement, empowerment, advocacy and community building; the economic perspective; and human resource. The provision of human services, such as health and education, contributes to general societal well-being and quality of life (Enjolras and Sivesind, 2018). Such services fill the gaps in those provided by the government (Abraham, 2003; Enjolras and Sivesind, 2018). Charities in the form of mutual cooperatives and social enterprises are significant sources of social innovation and change which are not normally exhibited by the market or existing institutions; they are noted to contribute to the integration of the labour market integration, the fight against social exclusion and poverty, the creation of social capital and the development of new ways to address social needs (Defourny and Develtere, 1999; Nicholls, 2004; Chaves and Monzón, 2012; Julià and Chaves, 2012). Thirdly, charities advocate the interests and values of individuals and groups (Habermas, 1998) and participate in policy networks (Rhodes, 1997) or advocacy coalitions (Sabatier, 1998). They have been noted to contribute significantly to social capital by increasing the trust levels amongst the relationship networks within a society; which in turn is a necessary element of democracy (Putnam, 1993, 2000). The fourth impact of charities is that from the economic perspective, whereby charities are a significant contributor to the Gross Domestic Product (GDP) in many developed nations. For instance, the third sector made up 0.7% of the GDP in United Kingdom (UK) in 2018 (Bénard, Davies, Dobbs, Hornung, Jochum, Lawson, McGarvey, 2018), 5.4% of the GDP in the United States (US) in 2015 (McKeever, 2018), and over 8% in Australia in 2014-2015 (Deloitte, 2017). Nonprofits further cause a multiplier effect on general economic activity by boosting related local businesses; for instance, attending an event organised by an arts-related charity would lead to spending in areas such as food and beverage, clothing, transportation and parking. In other words, the economic impact of the charity is extended, helping to create more jobs and generating more tax revenue for the local government (National Council of Nonprofits, Economic Impact, 2020). Charities also represent a major employer. In Europe, charities represent the largest, or second largest, workforce of any other industry in a number of European countries, especially when the full-time-equivalent work of volunteers is included (Salamon, 2010; Salamon, Anheier, List, Toepler and Sokolowski, 1999; Salamon and Sokolowski, 2004). In the US, nonprofits employ 12.3 million people, with payrolls exceeding those of most other US industries, including construction, transportation, and finance (National Council of Nonprofits, Economic Impact, 2020). The economic impact of charities reaches further over and above the Gross Domestic Product (GDP) and employment. Charities that provide child care or elder care free the family members to work outside the home, as well as provide job training and placement services for disadvantaged workers, such as those who are excluded from formal education channels, disabled and the long-term unemployed (Davister, Defourny and Grégoire, 2004; Haldane, 2014; National Council of Nonprofits, Economic Impact, 2020). The fifth impact of charities is from the human resource perspective. Employees and volunteers working for charities are found to experience benefits such as increased work and life satisfaction, improved general wellbeing, better social networks, improved skills and competences and enhanced employability (Wilson, 2000; Harbaugh, 2007; Meier, 2007; Dunn, Aknin and Norton, 2008; Choi and Kim, 2011; Rochester, Ellis Paine, Howlett and Zimmeck, 2010; Haldane, 2014; Frontier Economics, 2019). Finally, charities provide a wider value to donors in the form of intangible benefits such as increase in happiness and fulfilment (Dunn et.al., 2008; Aknin, Dunn, Norton, 2012).

It must be stated at this point that Malaysian statistics to-date do not reveal the charitable sector's contribution to the GDP nor a quantification of its role as a collective employer. However, the Malaysian government has begun to acknowledge the importance of the third sector by allocating a small fraction of healthcare funding (RM20 million out of a total of RM25 billion), via the 2017 Budget, to healthcare charities (Wan Jan, 2016).

In view of the foregoing important and diverse roles played by charities, it is to the advantage of the society and the nation that the functions of such charities continue for the long term. For that, the financial sustainability of charities needs to be ensured and preserved, because it provides the means by which a charity can continue to do its work and achieve impact. Charities can continue to serve high-need communities and provide services without interruption, while at the same time develop resilience to occasional economic shocks in the short term, such as temporary reduction of programme funds and variability in donations. This is especially pertinent under the challenging circumstances of funding limitations, lack of governmental support and donations, and general economic crises.

However, charity failure has been a problem that has been plaguing developed countries and developing alike. In 2019, the Foundation of Social Improvement noted in their Small Charity Index: Five Year Trends report that three in 10 charities feared closure in the next 12 months (Kantaria, 2019). Guidestar reported that around 50% of the nonprofits in the US operated from precarious financial positions of less than one month's cash reserves (Coffman, 2018). In 2016, the Charity Commission of the UK published a report in which the auditors of 94 charities noted that they faced "potential financial difficulty" distress; the said report further noted that nine of the 94 charities had since ceased to operate, while 10 were substantially restructuring their activities (Ainsworth, 2016). This report came on the heels of the actual collapse of a leading adoption charity, the British Association for Adoption and Fostering, in 2015 (Burns, 2015).

In the US, there have been a number of charity bankruptcy cases in recent years, such as Architecture for Humanity and the National Heritage Foundation (Fox, Blattmachr, and Bolas, 2015). Charitable foundations – non-profit organisations that donate funds and support to other organisations – were noted to experience poor investment returns, and had to face the choice between raiding into their endowment funds or reducing charitable activities (Foley, 2016).

In Asia, the two largest charities that made headlines in the past 10 years are based in Singapore: the National Kidney Foundation and City Harvest Church. These charities did not fail financially per se, but they experienced large-scale financial scandals which resulted in a large drop in church attendance (for City Harvest Church) (Cheong, 2015a; Cheong, 2016) and shaken trust amongst the donors (Cheong, 2015b; Wong, 2015).

In the case of Malaysia, the non-profit sector has not been formally outlined (Hashim, 2014) and as such official statistics on its performance are lacking at the macro level, unlike that of the for-profit sector. Evidence on financial sustainability problems are derived largely from findings of interviews from academic research and news reports. For example, Nga (2015) through interviews with civil society organisation officials, noted a greater difficulty in obtaining government funding as well as sponsorship from businesses (in cash or in kind), in times of financial crises. Kusmanto (2013) also noted from interviews with representatives of Malaysian registered NGO's that they faced reduction of funds for various reasons, including global recession, the general economic outlook and the lack of accountability and skepticism over the effectiveness of aid given.

It was reported in the Malaysian newspapers that charities have difficulties in raising donations due to the difficult economic climate (Wong, 2016). Several welfare homes were reported to be at the brink of survival due to the decline in donation levels, such as the Destiny Starting Point Welfare Association Klang (which runs three homes for delinquent children and one for the homeless, elderly, blind, people with physical or mental disabilities as well as those with tuberculosis and HIV), Rumah Kasih (a girls' home providing care and education to enable its inhabitants to support themselves into adulthood), and Pertubuhan Kebajikan Baitul Kasih (a home for underprivileged children) (Foo and Mohd Rani, 2017).

1.2. Problem Statement

Charity failure and their financial difficulties in the face of the difficult economic climate is a problematic issue which has the potential to adversely impact the economy and society. Current and academic literature have noted possible reasons for financial difficulties faced by charities, or outright charity failure. Other than macroeconomic (external) factors such as the adverse economic climate, weak stock market returns and low interest rates (Foley, 2016), possible reasons for charity failure or financial difficulties include internal factors such as governance failure or lack of accountability (Channel News Asia Singapore, 2012; Chan, 2009; Fernandez and Michael, 2009; Sunday Star, 2010; Calvary Today, n.d.; Daily Express, 2012; The Truth, 2013; James, 2014), dependence on public sector funding/fixed term contracts or grants, costs of setup, restructuring or reorganisation (Jacobs, 2009), pension scheme deficits (Cooper, 2013), unplanned overspending, funding uncertainties, contingent liabilities, inefficiencies and ineffectiveness of operations or services (Ainsworth, 2016), decreasing revenues/donations and increasing expenses (Fox, Blattmachr and Bolas, 2015; Winston, 2015; Foo and Mohd Rani, 2017) and lack of liquidity (Cooper, 2013). It has been alleged that certain charitable programmes attract more donations than others, such as those related to children and education (Wong, 2016). It was also suggested by Stevens Chan, the founder of Save One's Sight Mission Malaysia, that the sustainability of a charity is encouraged by its success in meeting the community’s needs and interests, and producing measurable results (Nais, 2013).

It would be pertinent, at this point, to highlight the further impacts of charity failures caused in particular by accountability failure, and prolonged continuance of any governance irregularities, which can be far reaching. Such events tend to be highly publicised, especially if the organisation in question is significant in size, thereby adversely affecting the reputation of the affected organisation, the third sector and Malaysia as a whole. Knock-on effects could include disruption to society, litigation, loss of investor confidence in the economic environment, and a worsening of Malaysia’s ranking under the Corruption Perceptions Index.

The internal factors causing financial sustainability as discussed in the foregoing can be summarised into accountability, financial management capacity and revenue diversification, which have been studied via past research in non-profit organisations (e.g. Abraham, 2003; Arshad, Abu Bakar, Wan Mohd Razali, Omar, 2013b; Hendrickse, 2008; Kirsch, 2013; Tevel, Katz and Brock, 2014; Omar, Arshad and Razali, 2013; Carroll and Stater, 2009; Ochieng, 2016; Rao, 2013; Azibo, 2014). Literature also have examined director tenure diversity, own income generation and organisation size as factors behind financial sustainability (e.g. Li and Wahid, 2017; DeBode, 2014; Keating, Fischer, Gordon and Greenlee, 2005). Some of these factors have already been studied on their effect on financial sustainability, either singly or multiply (e.g. Saungweme, 2014; Njoroge, 2013; Mawudor, 2016; Mohamed and Muturi, 2017). However, two research gaps are identified. Firstly, the impact of the identified factors on charity financial sustainability has not been studied within the Malaysian environment. The study of such factors is important given the recent and rapid growth of the third sector in Malaysia (Perai, 2019). Secondly, previous studies did not comprehensively examine all the identified factors within a single framework. Such a one-size-fits-all framework is needed so that it can be used to predict financial sustainability for charities of all types and of all sizes in the Malaysian context.

1.3. Research Objectives and Research Questions

Given the background of the study and the overview of the research problem, there is a need to understand the driving forces behind charity financial sustainability.

Research objectives

The general objective of this study is to investigate the factors influencing financial sustainability in charitable organisations.

The specific research objectives of this study are as follows:

(a) to determine the current state of financial sustainability of charities in Malaysia.

(b) to examine whether financial management capacity influences the financial sustainability of charities in Malaysia through own income generation, revenue diversification and organisation size.

(c) to examine whether accountability influences the financial sustainability of charities in Malaysia through revenue diversification and organisation size.

(d) to examine whether director tenure diversity influences the financial sustainability of charities in Malaysia directly and through own income generation, revenue diversification and organisation size.

Research questions

(a) What is the current state of financial sustainability of charities in Malaysia?

(b) Does financial management capacity influence the financial sustainability of charities in Malaysia through own income generation, revenue diversification and organisation size?

(c) Does accountability influence the financial sustainability of charities in Malaysia through revenue diversification and organisation size?

(d) Does director tenure diversity influence the financial sustainability of charities in Malaysia directly and through own income generation, revenue diversification and organisation size?

1.4. Significance of the Study

The significance of charities, their impact on the economy and society, and the need for them to maintain financial sustainability have already been discussed earlier.

From the practical perspective, it is envisaged that the final outcome of this study will be a confirmed and tested model of financial sustainability for charities, which can then be further utilised to develop a rating methodology, and thereafter an index, to rate the long-term sustainability of charities. This has practical uses and applications for various parties. Firstly, relevant government agencies can allocate funding based on the index, whereby charities that are determined to have high financial sustainability would qualify for a larger amount of funding, as they (via their management) would have been proven to be better stewards of their organisation and, by inference, of any future funding. In the same manner, banks can utilise the model/index to decide on whether to issue loans/financing to charities. Potential donors can decide whether to provide, continue or terminate financial support to charities based on the model/index. They can also use the model/index as an input when prioritising limited donation funds. Charities themselves can also use the index to benchmark themselves against other charities, and to highlight areas for future improvement.

Also, should a proven link between accountability and financial sustainability be discovered, it will lend weight to the inclusion of more governance-related provisions in the laws and policies pertaining to charities and the third sector in general. As a result, the legal and governance framework over charities, non-profit organisations and the third sector will be more effective. It is also vital not to forget that non-profit organisational governance affects the beneficiaries, who are frequently bound together within the social fabric of the organisation, and often forming part of the workforce as well as benefitting from access to employment. Therefore, good governance within non-profit organisations enhances social benefit in general.

From the theoretical perspective, this study has several contributions. It is the first study that attempted to comprehensively investigate, in a single framework, the financial and non-financial factors that influence the financial sustainability of charities. The financial factors refer to revenue diversification and own income generation, while non-financial factors refer to accountability, financial management capacity, director tenure diversity and organisation size. Previous studies have merely looked at individual factors such as accountability (e.g. Abraham, 2003), governance (e.g. Hendrickse, 2008), or mission drift (Spyker and Deol, 2014), funding sources (e.g. Rao, 2013) and own income generation (e.g. Azibo, 2014); or multiple factors (e.g. Saungweme, 2014; Njoroge, 2013; Mawudor, 2016; Mohamed and Muturi, 2017) and investigated (multiple) financial factors and their prediction ability on financial vulnerability (e.g. Tuckman and Chang, 1991; Greenlee and Trussel, 2000, 2004; Hager, 2001; Trussel, Greenlee and Brady, 2002; Keating, Fischer, Gordon and Greenlee, 2005; Omar, Arshad and Razali, 2013; Tevel, Katz and Brock, 2014). In summary, none of the previous studies have comprehensively investigated the financial and non-financial factors that lead to the financial sustainability of charities. Also, none of the previous studies have hypothesised a system of relationships between the aforementioned factors.

It is the second study to-date investigating financial sustainability in charities in the Malaysian environment. The first study (Arshad, Abu Bakar, Wan Mohd Razali and Omar, 2013) examined the relationship between financial vulnerability (the opposite of financial sustainability), risk management and accountability. However, Arshad et al.'s study measured financial vulnerability using financial indicators (ratios) such as efficiency, margin, stability and solvency rather than failure risk indicators, which is the perspective of this study. Also, Arshad et al.'s study concluded that financial vulnerability led to poor accountability, while this study considered accountability as a potential contributing factor towards financial sustainability. The different perspectives may yield contrasting results.

This study extended the ongoing accountability and governance-related research from that of listed companies, an area traditionally focused on (Brennan and Solomon, 2008), to that of non-profit organisations, and in particular charities. In addition, this study also extended the ongoing accountability and governance-related research in developing economies, as more established models of governance, applied and tested in developed economies, are starting to be implemented in countries with emerging stock markets (Brennan and Solomon, 2008). Brennan and Solomon noted that such studies had tended to focus on major developed economies such as Japan, Germany, Australia and Canada, but highlighted the fact that researchers were now turning their attention to corporate governance in developing economies. The locale and focus of this study, Malaysia, which has a developing economy, would satisfy this recommendation.

This study is envisaged to add to the body of knowledge on charity financial sustainability frameworks, as well as sustainability frameworks in general (e.g. Shediac-Rizkallah and Bone, 1998; Olsen, 1998; Dao, Langella and Carbo, 2011).

1.5. Definition of key terms

The key terms in this study are detailed below:

Key term		**Definition**
Charity	:	A non-profit organisation (NPO) that focuses on non-profit and philanthropic goals
Company limited by guarantee	:	A public company incorporated with the principal liability of its members limited by the constitution to such amount as the members undertake to contribute to the assets of the company if the company is wound up
Financial sustainability	:	The ability to maintain financial capacity over time in order to continue charitable operations
Financial management capacity	:	The ability to ensure the financial health of the charity
Accountability	:	The processes through which a charity responds to the information needs of stakeholders
Director tenure diversity	:	The mix of director tenure lengths on the charity board
Revenue diversification	:	The increase in the number of revenue streams from different sources to reduce dependency on a single revenue stream
Own income generation	:	The generation of commercial sources of income
Organisation size	:	The scope of an organisation measured in total assets

1.6. Summary outline of the thesis

The work is presented in self-contained chapters. **Chapter 1 (Introduction to the study)** focuses on the introduction and background to the study, the problem statement, research objectives, research questions, and the significance of the study. The composition, structure and organisation of the study are also outlined. **Chapter 2 (Charities and their institutional setting)** discusses charities and their institutional setting, which includes the types of charities, their legal status, their objectives and purpose and related accountability issues. **Chapter 3 (Literature review and theoretical framework)** is divided into two sections. The first section reviews past literature on the theoretical basis behind financial sustainability. An overview of theories, frameworks and paradigms, in particular those explaining the relationship of factors contributing to financial sustainability of organisations, is analysed, synthesised and deliberated upon. A theoretical framework is then proposed, and theoretical definitions of important terms and constructs comprising the proposed theoretical framework are presented. The second section presents the empirical literature relevant to the research questions/hypotheses. Gaps and inconsistencies are evaluated, explained and justified. **Chapter 4 (Methodology)** outlines the participants/subjects of this study, the instrumentation used to collect the data, and the procedures to be followed. **Chapter 5 (Data analysis and findings)** presents the findings of this study. A descriptive analysis of all variables. Structural equation modelling (SEM) is performed to test the study hypotheses on the relationships (and inter-relationships) amongst the independent and dependent variables. Under SEM, the specified study model is first identified according to the relevant rules. Subsequently, the study data is examined for potential issues such as adequacy of sample size, multicollinearity, presence of outliers, normality and missing data; rectification actions taken are also discussed. The study model is then estimated and its fit (global and local) to the data, as well as the significance of the estimated parameters, are evaluated. Finally, to test the validity of the study model, alternative theoretically plausible models representing competing hypotheses are used as comparison. **Chapter 6 (Discussion of findings)** discusses the findings of this study, organised by the research questions. Finally, **Chapter 7 (Conclusion)** discusses further contributions of the study other than that of the proven/disproved hypotheses, as well as other findings. The limitations of the study and future research recommendations are also presented.

CHAPTER 2

CHARITIES AND THEIR INSTITUTIONAL SETTINGS

2.1. Introduction

This chapter reviews the definition of a charity and its purpose, and it first describes the different types of organisations within the third sector. It also reviews the institutional setting and regulations of charities in various developed countries. In particular, the United States (US) was chosen as it is the largest developed country in the world; and the United Kingdom (UK) and Singapore as the European and Asian representatives respectively. The charity regulatory setting in Malaysia, a developing country, is then described. Charity watchdogs are also briefly reviewed. Finally, recent issues of financial sustainability for charities in Malaysia are briefly surveyed.

The purpose of this chapter is threefold. Firstly, charities are not as commonly understood compared to for-profit organisations. In particular, they are usually grouped together with non-profit organisations, social enterprises and non-government organisations (NGOs). Therefore, there is a need to specifically define charities for the purpose of this study. Secondly, in comparing the institutional settings between developed and developing countries, the legal and regulatory backdrop that may enable or limit the factors behind financial sustainability of charities can be better understood. Thirdly, in analysing the charity regulatory setting in Malaysia, it can be ascertained as to the type of information charities are required to submit to the regulatory bodies, which then indicates that the data requirements of this study can be satisfied.

2.2. The third sector

The third sector covers a range of different organisations with different structures and purposes, belonging neither to the public nor the private sector. It exists to meet the needs which are not provided by the private nor the public sectors; the former because it is unprofitable to do so, and the latter because of lack of public resources. Third sector organisations share fundamental elements, such as being independent from the government, do not operate solely with a view to profit and pursue specific goals which are often aligned with certain social or political perspectives.

Third sector organisations include mainly charities, voluntary and community groups, social enterprises and co-operatives. The following Table 2.1 summarises the main features of such organisations.

Table 2.1 Main features of third sector organisations

Feature:	Charity	Voluntary/ community groups	Social enterprises	Co-operatives
Purpose	Specific cause	To provide benefit to members and community	Specific social objective	To provide benefit to members
Structure	Formal	Informal	Formal	Formal
Profit orientation	Non-profit	Non-profit	Profit making	Can be non-profit or profit making
Management	Appointed trustees or directors	Elected management committee or active group members	Appointed directors	Appointed directors
Funding source	Grants from third parties and government, commercial income, donations	May include fee-for-service, crowd funding, and other creative avenues	Commercial income	Commercial income
Staff	Staff and/or volunteers	Volunteers	Staff and/or volunteers	Staff and/or volunteers
Governance, accounts and record keeping	Yes. Submission of relevant documentation to governing authority on a regular basis	Usually, simple accounts and minutes of meeting are kept by treasurer and secretary. No need for submission to an authority.	Yes. Submission of relevant documentation to governing authority on a regular basis	Yes. Submission of relevant documentation to governing authority on a regular basis

2.3. Definition of a charity or charitable organisation and its purpose

A charitable organisation is a non-profit organisation (NPO) that focuses on non-profit and philanthropic goals as well as social well-being (e.g. charitable, educational, religious, or other altruistic activities).

Charity Navigator ("How Do We Classify Charities?: Charity Navigator," n.d.), the largest charity evaluator in the US, has comprehensively categorised charities into nine categories/causes, based on the kinds of programmes and services provided, and by function.

They are as follows: (a) Animals (which includes Animal Rights, Welfare, and Services, Wildlife Conservation, Zoos and Aquariums); (b) Arts, Culture, Humanities (Libraries, Historical Societies and Landmark Preservation, Museums, Performing Arts, Public Broadcasting and Media); (c) Education (Universities, Graduate Schools, and Technological Institutes, Private Elementary and Secondary Schools, Other Education Programs and Services, Private Liberal Arts Colleges); (d) **E**nvironment (Environmental Protection and Conservation, Botanical Gardens, Parks, and Nature Centers); (e) Health (Diseases, Disorders, and Disciplines, Patient and Family Support, Treatment and Prevention Services, Medical Research); (f) Human Services (Children's and Family Services, Youth Development, Shelter, and Crisis Services, Food Banks, Food Pantries, and Food Distribution, Multipurpose Human Service Organisations, Homeless Services, Social Services); (g) International (Development and Relief Services, International Peace, Security, and Affairs, Humanitarian Relief Supplies, Single Country Support Organisations); (h) Public Benefit (Advocacy and Civil Rights, Fundraising Organisations, Research and Public Policy Institutions, Community Foundations, Community and Housing

Development); and lastly (i) Religion (Religious Activities, Religious Media and Broadcasting).

2.4. The institutional setting and regulation of charities in the US

In the US, there are two main types of charitable organisations: one is a private foundation and the other is a public charity ("What is the difference between a private foundation and a public charity?," n.d.). A private foundation generally does not directly engage in service activities (i.e. they are non-operating), but disburses funds for charitable purposes. A private foundation also usually obtains funds from an individual, family, corporation or any other single source, and does not solicit funds from the general public. Good examples of private foundations are the Bill and Melinda Gates Foundation and the J. Paul Getty Trust.

A foundation or a public charity, on the other hand, generally receives grants from individuals, government, and private foundations. They may engage in giving out grants, but most conduct direct service activities. Some examples of operating foundations or public charities are the Make a Wish Foundation and the World Wildlife Fund.

The requirements and procedures for forming charitable organisations, the registration and filing requirements, and the regulations, vary from state to state. For example, in California, charities and the professional fundraisers who solicit on their behalf are regulated by the Attorney General, in order to ensure that charitable assets are employed for their intended use and ensure that donation funds are not misapplied or fraudulently used. Any complaint of misuse of funds or fraud will be investigated by the attorneys and auditors of the Charitable Trusts Section. Another requirement is that all charitable trustees, fundraising professionals and nonprofit organisations that conduct raffles for charitable purposes must register and file annual financial disclosure reports with the Registry of Charitable Trusts, no later than 9 months after the close of the fiscal year. The independent audit and audit committee requirements apply to charities (other than those exempt from registration and reporting) with gross revenue of USD 2 million and above. ("Charities, State of California, Department of Justice," n.d.).

At the federal level, charities can apply for tax-exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). Other than exemption from tax, other benefits include being eligible to receive tax deductible charitable donations. A charity must be a corporation, trust or unincorporated association, and its purposes must be limited to being charitable, and permanently dedicate its assets to charitable purposes. The organisation also must refrain from undertaking a number of other activities such as participating in the political campaigns of candidates for local, state or federal office, and must ensure that its earnings do not benefit any individual. Annual financial reports (IRS Form 990) are required to be filed at the state and federal level, and be made available to public scrutiny (Inland Revenue Department, US, n.d.).

2.5. The institutional setting and regulation of charities in the UK

In the UK, charities are categorized into 5 main types of structures: charitable incorporated organisation (CIO), either an association CIO or foundation CIO; charitable company (limited by guarantee); unincorporated association; another incorporation, such as by Royal Charter; or trust (Charity Commission UK, n.d.).

English charities are legally regulated by the Charities Act 2011 ("Charities Act 2011," n.d.), Scottish charities are regulated by the Charities and Trustee

Investment (Scotland) Act 2005 ("Charities and Trustee Investment (Scotland) Act 2005," n.d.), The Public Services Reform (Scotland) Act 2010 ("Public Services Reform (Scotland) Act 2010," n.d.) and the Charities Accounts (Scotland) Regulations 2006 (as amended) ("The Charities Accounts (Scotland) Regulations 2006," n.d.), while Northern Irish charities are governed by the Charities Acts (Northern Ireland) 2008 ("Charities Act (Northern Ireland) 2008," n.d.) and 2013 ("Charities Act (Northern Ireland) 2013," n.d.).

For charities in England and Wales, organisations that have an income of more than £5,000, and for whom the law of England and Wales applies, must register with the Charity Commission for England and Wales. An organisation whose income does not exceed £5,000 cannot register with the Charity Commission for England and Wales (Charity Commission UK, n.d.). Exempt charities are those that are not subject to regulation by or registration with the Charity Commission, because they are already regulated by another body; they must however still comply with charity law (Charity Commission UK, n.d.). Such exempt charities include certain universities, museums and galleries, and Industrial and Provident (Community Benefit) and Friendly Societies including social housing providers (Charity Commission UK, n.d.).

In England and Wales, there is also a charity category called excepted charities. These do not need to register or submit annual returns, but they must comply with charity law and are regulated by the Charity Commission UK. A charity is excepted if its income is £100,000 or less, and falls into the following category: churches and chapels, charities providing premises for some types of schools, Scout and Guide groups and charitable service funds of armed forces.

Charities in Scotland must register with The Office of the Scottish Charity Regulator (OSCR) (The Office of the Scottish Charity Regulator, n.d.), while those in Northern Ireland must register with the Charity Commission for Northern Ireland, irrespective of size or annual income (The Charity Commission for Northern Ireland, n.d.).

Generally, charities in the UK need to complete and file annual returns, trustees' annual reports and signed annual accounts within a certain time period past the financial reporting date (Charity Commission UK, n.d.; The Office of the Scottish Charity Regulator, n.d.; The Charity Commission for Northern Ireland, n.d.).

The accounts of UK charities generally need to be either audited or independently examined. Charities which are companies would be audited under the Companies Act. In England and Wales, as well as Scotland, charities which meet the definition of a small company (and do not exceed the Companies Act audit threshold) may elect for audit exemption and opt to have their accounts audited or independently examined under the Charities Act, which offer a lower cost alternative to charities that do not require the higher level of assurance that audit can provide.

There are different audit requirements for charities, based on income and/or asset level. The requirements are summarised in the Table 2.2 below:

Table 2.2 Audit requirements for UK charities

Applicable to charities in:	**Gross income**	**Gross assets**	**Requirement**
England, Wales, Scotland and Northern Ireland	More than £500,000		Statutory audit
England, Wales and Scotland	More than £250,000	More than £3.26 million	Statutory audit
England, Wales and Scotland	Less than £500,000		Independent examination
England, Wales and Scotland	More than £250,000	More than £3.26 million	Independent examination
Northern Ireland	More than £100,000		Independent examination

(Sources: Charity Commission UK, n.d.; The Office of the Scottish Charity Regulator, 2012; "Charities Act (Northern Ireland) 2008," n.d.)

The difference between a statutory audit and an independent examination is that the latter is a simpler form of scrutiny than an audit but still provides stakeholders (such as trustees, funders, beneficiaries, and the public) with an assurance that the accounts of the charity have been reviewed by an independent person. Such a person must be a member of a professional accounting body listed in the Charities Act, which includes the Association of Chartered Certified Accountants (ACCA) and Chartered Institute of Management Accountants (CIMA). Charities with gross income of £25,000 or less are not generally required to have any form of external scrutiny. The Charity Commission UK advises that charities would need to have an audit committee and/or an internal audit function if their size, nature of activities and complexity warrant it (Charity Commission UK, n.d.; The Office of the Scottish Charity Regulator, 2012).