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An Integrated Ritual Effectiveness Accountability Reporting System (*i-REARs*) for Non-Profit Organizations

Saunah Zainon[1], Ruhaya Atan[2], Yap Bee Wah[3], Raja Adzrin Raja Ahmad[1], Ahmad Marzuki Amiruddin Othman[1] & Nurulzulaiha Sau'dah@Suhadak[4]

[1] Faculty of Accountancy, Universiti Teknologi MARA (UiTM), Cawangan Johor, Malaysia

[2] Financial Reporting at the Accounting Research Institute, Faculty of Accountancy, Universiti Teknologi MARA (UiTM), Shah Alam, Malaysia

[3] Centre of Statistical and Decision Science Studies, Faculty of Computer and Mathematical Sciences, Universiti Teknologi MARA, Shah Alam, Malaysia

[4] Faculty of Computer and Mathematical Sciences, Universiti Teknologi MARA, Cawangan Johor, Malaysia

Correspondence: Saunah Zainon, Faculty of Accountancy, Universiti Teknologi MARA (UiTM), Cawangan Johor, Malaysia. E-mail: saunah5885@yahoo.com

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Abstract

Not-for profit organizations (NPOs) play a vital role in any society because it brings about a positive social change in the community. NPOs are fundamentally different from government and corporate sectors in terms of purpose of establishment, ways of generating revenues, missions that are not quantified in dollars and cents, as well as its governance and sustainability. The presence of multiple stakeholders for NPOs, compared to commercial organizations demands greater transparency and accountability especially in terms of its reporting. Traditional financial statement with a sole focus on financial information limits the assessment of NPOs performance. This paper presents the development of an Integrated Ritual Effectiveness Accountability Reporting System (*i-REARs*). *i-REARs* is a unique system that encapsulates both the financial as well as the non-financial information. The system can improve the quality and efficiency of reporting and promote accountability and greater transparency.

Keywords: accountability, effectiveness, integrated, information system, NPOs, reporting

1. Introduction

1.1 Accounting and Financial Reporting in Non-Profit Organizations

Non-profit organizations (NPOs) accounting and financial reporting are essentially different from government or the private sector because of different needs of NPOs stakeholders as compared to the needs of governments and private sectors stakeholders. In addition, separate accounting and financial reporting are needed due to differences in the nature of NPOs. The differences include revenues generation, stakeholders, legal formation, and its social missions of non-profit seeking. For the government financial reports, the components of the conceptual framework for the preparation of financial reports is in accordance with the International Public Sector Accounting Standard Board (IPSAS, 2003). The Governmental Accounting Standards Board's (GASB) conceptual framework also prioritized the informational needs of their stakeholders of taxpayer and ratepayer, members of legislature, creditors, suppliers, the media and employees. Similarly, there is a wide range of stakeholders in NPOs context, which include NPOs officials, donors, resource providers, grantors and the society at large (Cordery & Morley, 2005) and they need information as provided in the financial reporting. Consequently, the NPO's financial reporting objectives should consider these various ranges of stakeholders on which public accountability is to be the cornerstone in building the NPOs financial reporting standards. One of the financial reporting issues of NPOs is the inclusion of accountability performance information (Thomas, 2007).

NPOs play an important role in the socio-economic process as much as the government and private sectors. NPOs having showcased unique features in serving important social missions, offer services at lower costs than the government or the private sector. NPOs, which have no specific owners, often provide goods and services to their stakeholders without any charges. They seek resources from donors: organizations as well as willing individuals, who do not expect economic benefits in return for their assistance (Barman, 2007; Sheehan, 1996). As the bottom line principle is not applied in any of the activities conducted by NPOs, NPOs need to develop better instruments for performance measurement to evaluate their work and achievements. One approach to evaluate the performance of an NPO is to measure the amount of resources spent on program services that are conducted to accomplish its purposes. A higher percentage of resources that is consumed on programme services compared to administration is considered as a positive performance indicator. Despite the lack of performance measures magnitude for NPOs, surveys such as that conducted by (Glynn, Murphy, Perrin, & Abraham, 2003) have shown that performance measures based on the resources spent on programme services also helps to identify the organizational issues by detecting financial anomalies and focusing attention to the organizational performance.

Performance measurement has become an essential issue in NPOs. One question that needs to be asked, however, is whether the performance measurement used by the government or the private sector is appropriate to be used by the NPOs. As an entity with no commercial motive, NPOs have missions that cannot be quantified in dollars and cents. (Razek, Hosch, & Ives, 2000) argued that NPOs performance measurement is different from that of other organizations in terms of: (i) purposes of operation without earning profit, (ii) efficiency and effectiveness which cannot be determined by means of income measures, and (iii) act of receiving large amounts of resources from donors who do not expect monetary benefits in return.

NPOs' performance can also be assessed by analyzing the information provided in traditional financial statements in order to meet the requirements of stakeholders who need to examine NPOs accountability for decision making in terms of social and economic aspects. The stakeholders also need the information to assess the NPOs' stewardship of resources, including evaluating the manner and extent to which resources are devoted to specific social missions. However, it is found that there are limitations of traditional financial statements in assessing NPO performance (FASB, 1989). In pronouncement issued by the FASB, Concepts Statement No. 4, Objectives of Financial Reporting by Non-business Organizations, it was highlighted that there is a need for a different type of information to measure NPOs performance. An important argument that has drawn attention in the Concepts Statement No. 4 is that, in an ideal situation, NPOs should provide information about service accomplishments as a part of financial reporting. The statement calls for reporting in the financial statements about service efforts on how an NPO uses resources to provide different programmes or services to fulfill its missions.

1.2 Information in NPOs Reporting

Traditional financial statements only include the financial information which limits the assessment for NPOs performance (Financial Accounting Standards Board, 1980). There are three major bodies that issues standards for NPOs in the United States (U.S.). They are the Financial Accounting Standards Board (FASB), the American Institute of Certified Public Accountants (AICPA), and the U.S. Federal Office of Management and Budget (OMB). The FASB is the main standards issuing body and has developed two statements of financial accounting standards for NPOs. These are Statement No. 116, "Accounting for Contributions Received and Contributions Made" and No. 117 "Financial Statements of Not-for-Profit Organizations." The AICPA publishes the primary guideline of Generally Accepted Accounting Principles (GAAP) for NPOs, the "Not-for-Profit Organizations Audit & Accounting Guide." The OMB publishes standards and guidelines for NPOs that receive federal grants. All the above standards concern only the reporting on the financial information. Nevertheless, the NPOs stakeholders not only concern on the financial information, but also the non-financial information (Ruhaya, Saunah, & Yap, 2012).

Due to the needs for the integration of both financial and non-financial information in NPOs reporting, an Integrated Ritual Effectiveness Accountability Reporting System (*i-REARs*) is designed to reflect different needs of NPOs stakeholders. The design of *i-REARs* is based on conceptual framework developed in an integrated ritual effectiveness accountability reporting. There are four main components in the conceptual framework which include (i) financial information, and non-financial information of (ii) governance information, (iii) accountability, and (iv) transparency. To integrate both the financial and non-financial information, firstly, the statutory financial information required by the Registry of Society (ROS) governed by the Society Act 1966 (Act 335) & Regulations 1984 is included in the framework i.e., the Statement of Financial Position or Balance Sheet and the Statement of Receipts and Payments. Other financial information of the Sources of Funds and Uses of Funds are also included for the purpose of measuring the financial health of NPOs. Information which is not recognized by the financial reporting, termed as non-financial information such as the governance, accountability and transparency information, is integrated with the financial information. The non-financial information serves as the indicators for the organization's efficiency and effectiveness that cannot be determined by means of financial measures (Razek et al., 2000). Through integration, these four components of information act as foundations for the integrated ritual effectiveness accountability reporting before *i-REARs* is designed.

The remainder of this paper is as follows. Section 2 discusses the reasons for differences in NPOs financial reporting. Section 3 provides the terminologies. Section 4 defines the conceptual framework for *i-REARs*. Section 5 discusses the system design methods whilst Section 6 provides the prototyping methodology of *i-REARs* and Section 7 concludes the study.

2. Different Financial Reporting for NPOs

NPOs accounting and financial reporting requirements focus on the needs of multiple stakeholders. The stakeholders need the information to assess the NPOs' stewardship of resources, including evaluating the manner and extent to which resources are devoted to specific social missions. In particular, most of the information in the annual reports is used by the key stakeholder, the donors, for them to make informed decision on donation decision making. Previous studies have shown that donors obtained necessary information to assess and evaluate the performance efficiency of NPOs (Callen, 1994; Tinkelman, 1998, 1999). The integration of both the financial and non-financial information (Palmer, Isaacs, & D'Silva, 2001; Ruhaya et al., 2012; Saunah, Ruhaya, Yap, & Raja, 2012) in NPOs annual reports are often disclosed in the financial statements for the financial information and sustainability reports such as service efforts and accomplishment (SEA) reports for the non-financial information. The needs of the NPOs' stakeholders emphasized on the "accountability" for resources entrusted to the resource managers. On the other hand, the stakeholders of business entities emphasized information for investment. Business entities are consistent with their basic operations; (i) they exist to make profit, (ii) only deliver private goods and services, (iii) their expenses derived directly from their efforts to earn those revenues, and (iv) the beneficiaries of private goods and services are identical to those that provide the revenue (Beechy, 2007, p. 16). However, it is found that there are limitations of traditional financial statements in assessing NPO performance (FASB, 1989).

The financial reporting issues for NPOs are the integration of both statutory financial reporting and accountability reporting. Practically, the information contained in the financial statement should include both accountability performance information and financial statements. Financial reporting of NPOs aim to address the need for public accountability information by helping the stakeholders assess how resources are required and utilized. Stakeholders also need the information to determine compliance with legally authorized monitoring bodies or authority.

NPOs accounting and financial reporting are essentially different because of different needs of NPOs stakeholders as compared to the needs of governments and private sectors stakeholders. In addition, separate accounting and financial reporting are needed due to differences in the nature of NPOs. The differences include revenues generation, stakeholders, legal formation, and its social missions of non-profit seeking. Financial reporting of NPOs aim to address the need for public accountability information by helping the stakeholders assess how resources are required and utilized. Stakeholders also need the information to determine compliance with legally authorized monitoring bodies or authority. NPOs are unique and complex; they run more activities not businesses. The stewardship responsibility for NPOs reporting is merely based on accountability. Thus, in order to enhance the quality of reporting information for NPOs, an Integrated Ritual Effectiveness Accountability Reporting System (*i-REARs*) for NPOs is developed.

3. Terminologies

For a better understanding of the institutional context of the study, it is important to provide a brief explanation of the various terms used throughout this study. In Malaysia, the term "non-governmental organizations" (NGOs) is being used more often to describe NPOs. Other terms are used in the academic and literature to describe NGOs, for example, "nonprofits (non-profits, not-for-profit (NFP)," "voluntary associations," "community social welfare organizations," "international non-governmental organizations," "charity sector," "citizen sector," or "membership support organizations." The terms "third sector" and "voluntary sector" are commonly used in the United Kingdom and New Zealand. In the United States, the term NGOs has also been used interchangeably with "private voluntary organizations" (PVOs) or "private non-profit organizations" (Kearns, 1994). An appropriate nomenclature to be used in a study is the subject of great ideological debate. In this study, the term NGOs, non-profits, charity organizations, charity and NPOs are used interchangeably. An NPO is an entity whose principal objective is not for profit. Herzlinger (1996) defines a non-profit as a body of individuals who associate for any of the following purposes: (i) to perform public tasks delegated to them by the state; (ii) to perform public tasks for which there is a demand that neither the state nor for-profit organisations are willing to fulfil, and (iii) to influence the direction of the policy in the state for the NPOs. Another definition of NPOs by Salamon (1997) is organizations established by five circumstances:

(i) formal organizations;

(ii) private (separated from government);

(iii) not-for-profit distributing;

(iv) self-governing and;

(v) voluntary.

Charity—The word charity originates from the Latin caritas, which means *"dearness"* (Cordery & Baskerville, 2011). It refers to kind acts towards those who are less fortunate. From a narrower perspective, the term charity falls within the subset of NPOs, committed to addressing social needs and improving the human condition, and is further defined by Heinrich (2000) as *"public provision for the relief of the needy"* and charitable as liberal in benefactions (the act of doing something good) to the poor.

Charity organizations—The legal definition of *"charitable purposes"* formed under Section 2 of the Malaysia Income Tax Act (ITA) 1967. The charity organizations are defined by Section 2 of the ITA 1967 as the organizations established within these four headings: (i) the relief of poverty; (ii) the advancement of education; (iii) the advancement of religion; and (iv) other purposes beneficial to the community not falling under the preceding heads.

Societies—Based on Section 2 of the Societies Act 1966 (Act 335) & Societies Regulations 1984, a society is defined as inclusive of any club, company, partnership or association of seven (7) or more persons, whatever its nature or object, whether temporary or permanent, but does not include:

(a) any company registered under the provisions of any written law;

(b) any company or association constituted under any written law;

(c) any trade union registered or required to be registered under any written law;

(d) any company, association or partnership formed for the sole purpose of carrying out any lawful business that has as its object, the acquisition of gain;

(e) any cooperative society registered under any written law;

(f) any organization or association established under any written law relating to the registration of schools, that such organization or association forms part of the curriculum of a school;

(g) any school, management committee of a school, parents' association of parent-teachers' association registered or exempted from registration under any law.

Charitable corporationsor company limited by guarantee—Section 24(1) of the Companies Act 1965 defines charitable corporations as 'a proposed limited company being formed for the purpose of providing recreation or amusement or promoting commerce, industry, art, science, religion, charity, pension or super annuation schemes or any other object useful to the community, and will apply its profits (if any) or other income in promoting its objects and will prohibit the payment of any dividend to its members.'

4. Conceptual Framework for *i-REARs*

Financial statements show the results of the stewardship of management, and/or the accountability for resources entrusted to the management. Donors are the primary stakeholders of the information in NPOs reporting. NPOs reporting are generally used by donors who emphasized accountability for resources entrusted to them. The needs of the stakeholders, particularly the donors, of the NPOs financial reports are reflected in the differences in the components of the *i-REARs*conceptual framework.

In *i-REARs*, an integrated system allows a combination of the financial and non-financial information in one single report. Based on integrated reporting, *"ritual"* or the *"truth"* or the *"real"* picture of the NPOs performance is revealed, enabling the stakeholders to assess management's financial and non-financial stewardship. On the other hand, a different concept of accountability is embodied in NPOs. The *CICA Handbook* asserts the purpose of NPOs financial statements:

> *... provides information about the cost of the organization's service delivery activities for the period and the extent to which these expenses were financed or funded by contributions and other revenue. The information provided in the statement of operations is useful in evaluating the organization's performance*

> *during the period, including its ability to continue to provide services, and in assessing how the organization's management has discharged its stewardship responsibilities* (Handbook, Section 4400).

Accountability, in a general sense is a responsibility of stewards or agents to provide relevant and reliable information relating to resources under their control. Accountability in NPOs reflects their financial reporting preparation in the following manner: (i) to provide information to the financial statement reader about the cost of service delivery activities; and (ii) to assess the NPOs financial and non-financial stewardship. In his major study, Thomas (2007) defined accountability as gathering information about, reporting on and answering questions related to performance does not come up to the level of full accountability. Transparency in performance is a means to achieve accountability through which can be measured through NPOs effectiveness. At the heart of our understanding, combining the accountability performance information with the traditional financial statements in one report is generally an integration of the linkage between accountability performance information and financial information.

Accountability performance information includes both the governance and transparency aspects of information. From the above discussion, it is apparent for the NPOs to have an integrated reporting system as performance measurement tool that can satisfy both NPOs stakeholders (in particular the donors as the primary NPOs stakeholders) and NPOs management interests (Mueller, Rickman, & Wichman-Tau, 2006). From the reporting integration, the real truth and ritual of NPOs performance is reflected in the Integrated Ritual Effectiveness Accountability Reporting (*i-REARs*). Figure 1 below depicts the conceptual framework for *i-REARs*.

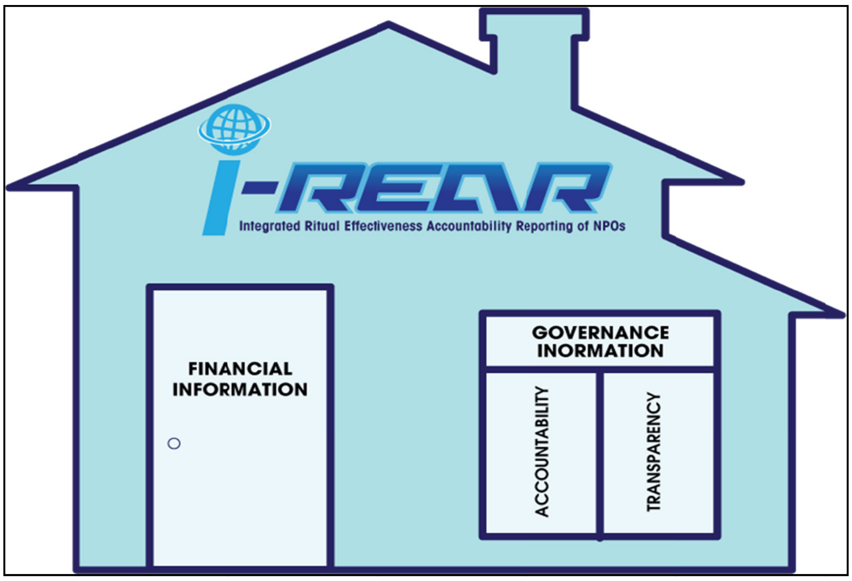

Figure 1. Conceptual framework of *i-REARs*

In *i-REARs* conceptual framework, the component for financial information is based on the statutory requirement of the Society Act 1966 (Act 335) & Regulations 1984 under the Registry of Society (ROS), which consists of the Statement of Financial Position or Balance Sheet and the Statement of Receipts and Payments. Other financial information of the Sources of Funds and Uses of Funds are also included for the purpose of measuring the financial health of NPOs. Information which is not recognized by the financial reporting, termed as non-financial information such as the governance, accountability and transparency information are integrated with the financial information. The non-financial information are the indicators of the organisation's efficiency and effectiveness that cannot be determined by means of financial measures (Razek et al., 2000). The objective of *i-REARs* is toenhance the quality of NPOs reporting by means of accountability and transparency in order to satisfy the stakeholders needs for information. The conceptual framework of *i-REARs* is based on four key components: (i) financial and non-financial information (ii) governance information, (iii) accountability, and (iv) transparency. A summary of the *i-REARs* components is shown in Table 1.

Table 1. Four components of *i-REARs*

Component 1 (Financial Information)	**Sources of Funds** • Membership Fees • Individual Donation • Corporate Donation • Public Grants (Government Grants) • Sponsors • Other Revenues **Uses of Funds as Percentage of Total Expenses:** • Programme Expenses • Administrative Expenses • Fundraising Expenses **Regulatory Requirement by the Registry of Society:** • Statement of Financial Position or Balance Sheet • Statement of Receipts and Payments
Component 2 (Governance Information)	**Disclosure Items:** • Name of Chairperson/President/Director • Chair's Profession/Affiliation • Board Size • Paid Staff Size • Principal Activities • Vision • Mission • Core Values • Patron's Message • President's Message • Organizational Chart • Board of Trustees • Committee Members • Calendar of Events • Organizational Code of Conduct • Statutory Declaration by Honorary Treasurer • Internal Auditors • External Auditors • Auditors' Report • Executive Council Report • Statement of Activities • Volunteering • In-Kind • Corporate Partnership Involvement • Name List of Major Donors

	• Collaborations • Corporate Employee Voluntarism • Governance and Policies
Component 3 (Accountability)	• Statement of Accountability • Related-Party Transactions • Accountability Partnership • Internal Controls • Risk Management
Component 4 (Transparency)	• Statement of Transparency • Confidentiality and Privacy • Donor Privacy Policy • Information about Current and Past Achievements • Future Plans

Through integration between financial and non-financial information, these four components of information act as foundations for the *i-REARs* conceptual framework before an actual Integrated Ritual Effectiveness Accountability Reporting System (*i-REARs*) is designed.

5. System Design Methods for *i-REARs*

A system is a set of related components that produces specific results. The purpose of system design is to create a technical solution that satisfies the functional requirements for the system (Palaski, 2001) and satisfies the stakeholders needs. In the case of *i-REARs*, the integrated accountability reporting system is developed in order to improve NPOs accountability and serve as a tool for monitoring and decision making. With *i-REARs*, the stakeholders can easily portray what the NPOs have done or achieved or what difference have been made from previous years. The management of NPOs can use *i-REARs* to help their own organisations to develop meaningful performance measures that will enable them to achieve their goals and missions at both the organisational and the community levels. In sum, *i-REARs* is an important tool allowing the stakeholders to make social decisions on programme priorities, and economic decisions on resource allocations needed by NPOs to reach their goals. For the earlier stages of the designing of *i-REARs* and features of i-REARs report. *i-REARs* provides the opportunities for NPOs to explain the areas that the accounts (financial statements) do not explain. In order to fully understand the process in designing the *i-REARs*, it is helpful to take an initial cursory glance at the stages in the system design method.

Before a new system is developed and put in place, it needs to undergo several phases for system design. Generally, system design requires three main processes: (1) preparation for system requirements analysis, (2) preparation for system design and (3) preparation for system construction. In process 1, the current project system is analysed and expanded to accommodate the design work products. The technical environment and tools needed to support the sysstem design is established in this process. The preaparation for system design is built in Process 2. The foundation and structure of the system are identified in terms of its operational requirements such as the system hardware, system software and supporting tools. These operational requirements are then translated into a series of technical design specifications in order to move on to the next process. Process 3 involves the construction and implementation of the system. In this process, the system is refined, validated and optimized to ensure the completeness, accuracy and reliability of the data in the system design.

In selecting the system design method, there are two approaches. The first is to improve the efficiency and responsiveness of the traditional system development life cycle (SDLC) approach, while the other is to employ a prototyping method in the development process (Mahmood, 1987). SDLC approach is a traditional method that still is widely used, is in the form of user involvement, and the prototype approach, on the other hand, which is a newer approach that many users prefer, receives greater support because (i) it allows more concrete identification and validation of user information requirements (Coughlin, 1981), (ii) facilitates implementation and user acceptance (Dearnley & Mayhew, 1983), (iii) elucidates the design best suited to the user's individual cognitive style, (iv) improves communication between users and designers, and (v) encourages enthusiasm and commitment during the development process which results in more satisfied users. Table 2 presents the differences between SDLC and prototype approach.

Table 2. SDLC vs. Prototyping

Design Method	Information Requirements	System Representation	Changes in Design
SDLC	predetermined	user deals with explanations, diagrams and charts or proposed system	minimized
Prototyping	best developed in parallel with coding rather than serially	user deals with a realistic view of the system	encouraged

Source: Mahmood (1987).

6. Prototyping Methodology of *i-REARs*

Prototyping is an engineering technique used to develop partial but functional versions of a system or applications. Prototyping allows users to examine a model that accurately represents system outputs, inputs, interfaces, and processes. Prototyping produces an early, rapidly constructed working version of the proposed information system, called a prototype. When extended to system design and construction, a prototype can evolve into the final, implemented system. The design of *i-REARs* in this study is using the prototyping approach due to its perceived benefits such as (i) prototyping is real, (ii) prototyping provides common based-lines, (iii) visible to the users and (iv) establishes better relationships. Figure 2 illustrates the prototyping methodology used in designing *i-REARs*. It involves planning, analysis, design and implementation process. The prototyping system is developed before full implementation of the actual *i-REARs* system.

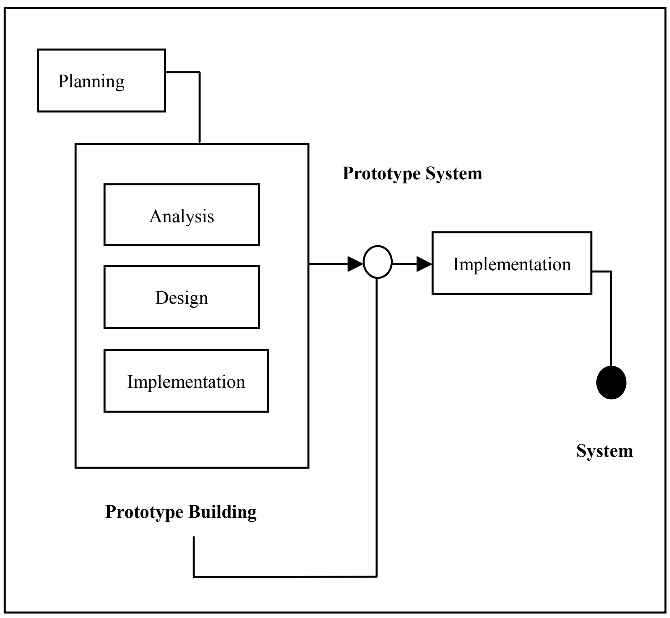

Figure 2. Prototyping methodology in *i-REARs*

7. Conclusion

The role and contribution of NPOs is undeniably very important as it acts as a vehicle for promoting the well-being of the society. Stakeholders now place a premium on NPOs that demonstrate greater accountability in discharging their stewardship responsibilities. In order to enhance the quality of financial reporting information for NPOs, an Integrated Ritual Effectiveness Accountability Reporting System (*i-REARs*) is developed. Compared to other accounting system, *i-REARs* is a unique system because it integrates the financial and non-financial information. Whilst financial information provides information with regards to the financial health of the organization, the non-financial information, such as the governance status, reflects the organization's efficiency and effectiveness. In terms of system design, *i-REARs*is exclusive because it is developed using the prototyping approach. This approach is better because it uses an iterative process and greatly ensure user acceptance of the final system (reference). Additionally, in designing *i-REARs*, the non-negotiable requirement of an organization's management is also taken into consideration. With the enhanced demand on organizational creativity and institutional adaptability, the application of *i-REARs* could provide a positive contribution to sustainable practices and also add value in terms of stakeholder engagement strategies.

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