Governance of Non-Profit Organizations in Developing Countries: Malaysia and Indonesia

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Abstract

Non-profit organizations (NPOs) play a significant role in the implementation of Sustainable Development Goals (SDGs) by serving as intermediaries between governments, communities, and businesses, facilitating the localization and contextualization of global goals, including developing countries. Malaysia and Indonesia are two prominent developing countries in Southeast Asia. Despite sharing similar socioeconomic contexts, both countries may exhibit different approaches to regulating and governing their non-profit sector. Drawing upon the existing literature and governmental documents, this study discusses a comparative analysis of the regulation and governance of NPOs in Malaysia and Indonesia. Specifically, this study discusses the similarities and differences in terms of the legal framework governing the formation, existence, and tax treatment for NPOs in both countries. By identifying the similarities and differences, this study contributes a deeper understanding of the opportunities and challenges governing NPOs in developing countries.

Keywords: Non-profit organisations, Regulation, Governance, Developing countries

1. Introduction

The Sustainable Development Goals (SDGs) serve as a universal call to action to end poverty, protect the planet, and ensure prosperity for all. Commitment from the various stakeholders, including, but not limited to, local authorities, workers and trade unions, businesses and industries, non-profit organisations (NPOs), and local communities, is required to achieve SDG 2030. Specifically, NPOs are "the organisation that primarily raises or disburses funds for charitable, religious, cultural, educational, and social purposes or carries out other types of 'good works' (FATF, 2019). They are neither public nor private sector, hence generally categorised under the Third Sector as they complement or provide services that the government did not or failed to cater to (Adro & Fernandes, 2021; Perai, 2021). As one of the enablers for sustainable development achievement, NPOs address social issues and the social needs of society (Hassan et al., 2018; Moldavanova & Wright, 2019; UNDP, 2019).

The emerging roles of NPOs in addressing social issues in society have drawn researchers' interest in better understanding the governance of NPOs, especially in terms of formation and relevant tax treatment. Zulkhibri (2014) has conducted a comparative analysis of the regulation, the applicable Law, and the tax treatment in the operations of NPOs in developing countries, specifically in countries: Afghanistan, Algeria, Indonesia, Iraq, Jordan, Nigeria, Pakistan, Tajikistan, Turkey, Turkmenistan, Saudi Arabia, Sierra Leone, Uganda, Uzbekistan, and Yemen.

However, throughout the years, the non-profit sector may have undergone changes in regulations and governance as their roles and importance have been evolving broadly. The external environment influences the growth of NPOs, especially in terms of government support (Bartosova & Podhorska, 2021). Besides, NPOs' role becomes more significant during the COVID-19 pandemic as they meet the needs, bridge gaps, and play numerous roles that leverage their strengths and showcase their critical impact on society (Centre for Asian Philanthropy and Society, 2021; Das, 2022). Hence, it is essential to understand the governance of NPOs as they are taking active and complementary roles in fulfilling the needs of society through various interventions to resolve social issues and ensure sustainable development in the community.

Although there is abundant research on the importance and governance of NPOs in developed economies, comparable analysis involving developing countries still needs to be improved. The environment in which NPOs operate to meet societal needs in Asia is understudied (Centre for Asian Philanthropy and Society, 2018). Hence, addressing this limitation, this study first discusses the importance of NPOs. Next, based on existing literature, reports and practitioners' documents, this study further analyses the governance of NPOs, specifically in terms of formation and tax treatment for the NPOs in Malaysia and Indonesia. These two countries are selected for this study due to the tremendous growth of their NPOs.

As of September 2021, the total number of registered non-governmental organisations (NGOs) in Malaysia stands at 82,675 (Abiddin et al., 2022). Meanwhile, the NPOs in Indonesia are rapidly growing, with 105,383 registered NPOs as of June 2022, as stated by the Ministry of Law and Human Rights (MMW Property, 2023). Despite the rapid growth of NPOs, as per the researcher's knowledge, there is limited literature on NPOs in Malaysia and Indonesia. This scenario demonstrates the wide gap between research and practice in non-profit sectors. In terms of theoretical contribution, this study will provide an understanding of how regulators and NPOs can design an appropriate framework for the growth and development of the non-profit sector based on the current structure and governance of existing NPOs in both countries. In terms of practical contribution, this study highlights the prevalent issues concerning the governance of non-profit sectors that NPOs and regulators could address.

2. Importance of NPOs

As countries progress towards a vibrant economy and a diverse community, their social dynamics become more complex (Dali et al., 2017). This scenario prevails as notified through the study by The Boston Consulting Group (BCG), 2018, entitled "Striking a Balance Between Well-Being and Growth: The 2018 Sustainable Economic Development Assessment". In principle, society's well-being is prioritised by national policy and government action in most countries across the world. Nevertheless, in practice, the government faces competing priorities between improving the well-being of society and fostering economic growth (Hrotko et al., 2018).

The combination of a strong economy and increasing population accompanied by complex social environments is more likely to lead to social issues such as socioeconomic inequalities (Agensi Inovasi Malaysia, 2017; Ministry of Economic Affairs, 2018) and breed crimes such as theft. Unresolved social issues may hamper countries' development, especially in the effort to accomplish the Sustainable Development Goals (SDG) 2030 by the United Nations. Typically, the unfulfilled needs by the public sector happen due to inadequate public support or statutory basis, while the private sector primarily emphasises profit. Usually, the business sector does not satisfy the needs of the people because it cannot do so profitably. Thus, the non-profit sector exists to accomplish goals that are neither financially nor politically viable.

The non-profit sector is essential to boost the economy and social development of developing countries. In this region, particularly in Malaysia and Indonesia, thousands of operational NPOs provide social services to their respective communities in areas such as, but not unlimited to, charity, health, education, and environment. NPOs create social values by addressing unfavourable situations to improve the beneficiaries’ economic standards of living (Omar et al., 2016; Weerawardena et al., 2019).

The primary functions of NPOs include caring for unfortunate individuals’ welfare, such as providing shelter and aid during the aftermath of natural disasters, providing educational awareness and inspiring critical analysis of the social environment, and advocating public policies and corruption prevention (Abiddin et al., 2022). During and post-COVID-19 period, the role of NPOs has become more significant as they meet the needs, bridge gaps, and play a variety of roles that leverage their strengths and showcase their critical impact on society (Centre for Asian Philanthropy and Society, 2021; Das, 2022). Without a doubt, NPOs play a vital role in overcoming social issues in areas where the authorities are not able to provide direct assistance.

3. Governance of NPOs in Malaysia and Indonesia

3.1 Formation/Types of NPOs

In general, NPOs may take various forms of structure and names, but unlimited to; third sector organization (Macmillan, 2010), NPOs (Arshad et al., 2018; Bellante et al., 2018; Casais & Santos, 2018; Ceptureanu et al., 2017, 2018; Lee & Nowell, 2015; Omar et al., 2016; Paulo, 2017; Ruhaya et al., 2017), non-governmental organisation (NGOs) (Cordery et al., 2019; Dewi et al., 2019; Agyemang et al., 2017; Goncharenko, 2019; Hailey, 2014; Yasmin & Ghafran, 2019), social purpose organisation (Agensi Inovasi Malaysia, 2017), civil society organisations (Lecy et al., 2012), and social delivery organisation (Centre for Asian Philanthropy and Society, 2018).

The various terms refer to common characteristics of the organisation, such as a separate entity from the government, involving voluntary works and social objectives as a priority (Gajdová & Majdúchová, 2018). However, this study consistently employs the term NPOs as it denotes the most used term in non-profit literature (Laurett & Ferreira, 2018).

Table 1. Summary of findings for NPOs in Malaysia and Indonesia

Criteria	**NPOs in Malaysia**	**NPOs in Indonesia**
Formation/ Types of NPOs	Various forms: CLBG, Societies, Trustee/Foundation, Youth associations, Labuan Foundation, State Foundations	Various forms: Foundations, Associations, Societal organizations without legal entity status, other specific types
Regulators	CCM, ROS, BHEUU, ROY, Labuan FSA, State Enactments	Ministry of Law and Human Rights, Ministry of Home Affairs
Tax Treatment	Tax exemption is available for eligible NPOs under Section 44(6) of the Income Tax Act 1967	Generally subject to taxes, some exemptions for specific purposes

By referring to the Table 1 above, NPOs in Malaysia may be established under the following regulations:

i. Company Limited by Guarantee (CLBG) governed by the Companies Commission of Malaysia (CCM) – incorporated under the Companies Act 2016 [Act 777]

ii. Societies, organisations, and associations governed by the Registrar of Society (ROS)- registered under the Societies Act 1966 [Act 335]

iii. Incorporation Trustee/ Foundation governed by Legal Affairs Division (BHEUU) –incorporated under Trustees Act 1952 [Act 258] / Establishment of Trustees Incorporation by the founder (associations of person/ body corporate)

iv. Youth associations registered with the Registrar of Youth Societies (ROY)

v. Labuan Foundation is registered under the Labuan Foundation Act 2010 [Act 706] and governed by the Labuan Financial Services Authority (Labuan FSA)

vi. State Foundations are registered under the State Enactments governed by each state in Malaysia.

Societies under ROS refer to “any club, company, partnership, or association of seven or more persons whatever its nature or object, whether temporary or permanent” (Societies Act 1966 (Act 335), 2006). Apart from the nominal registration fee, NPOs under ROS are not obligated to meet any financial requirement by ROS. NPOs registered under CCM must have RM 1 million in initial funds, while NPOs registered under BHEUU require RM 1,000. CLBGs can run business operations but have restrictions in terms of profit distribution. Societies under the ROS are conduits for social and associational life, while trusts and foundations registered with BHEUU and Labuan FSA have charitable objectives (Perai, 2019).

In Malaysia, state foundations assist society by offering financial aid and services on behalf of the state. Malaysia consists of 14 states, each with at least one foundation dedicated to achieving its objectives and purposes. Many state foundations in Malaysia mainly concentrate on education by offering loans and scholarships to young individuals. Some also assist in the entrepreneurial field and housing loans. The objectives of a foundation usually serve as the backbone of the state's mission and vision. While most state foundations are established in accordance with state statutes, some are also structured as Companies Limited by Guarantee (Ghazali et al., 2022).

The various types of NPOs serve different purposes and are governed by various regulators. Consequently, the registration requirement varies between different regulators. For example, CCM requires CLBG to have a company secretary and at least a director. Meanwhile, BHEUU requires a minimum of two individuals, a company or society as a founding trustee. To establish a society, the ROS and ROY require a pro-tem committee of seven founding members (Perai, 2019). The appointed registered Labuan trust corporation will be the secretary of the proposed Labuan Foundation and will be responsible for overseeing the registration procedure. If the Foundation intends to collect donations from the public, it must appoint a council of a minimum of three, which comprises most members independent from the founder. State enactments also require a typical structure of the BOT comprising the Chief Minister (Menteri Besar) as the Chairman, the State Secretary as the Vice Chairman and the State Financial Officer as the member. This position will remain in effect notwithstanding the replacement of the individual (Ghazali et al., 2022).

NPOs in Indonesia can be set up as "societal organisations" under three types of NPOs, namely Foundations, Associations, and Societal organisations without legal entity status. They are being established under the Minister of Law and Human Rights, released in 2014 the Regulation No.5 of 2014 on Validation of Foundations. The Law on Foundations defines a Foundation as a non-membership legal entity established based on the separation of assets and intended as a vehicle for attaining specific purposes in the social, religious, or humanitarian fields. Foundations can be set up by foreign entities or foundations or through collaboration among Indonesian citizens and foreign nationals. The Foundation must consist of a Governing Board (Badan Pembina), Supervisory Board (Badan Pengawas) and Executive Board (Badan Pengurus). Meanwhile, associations and Social organisations are membership-based organisations. To set up Associations, they must consist of at least three Indonesian citizens.

Other forms of NPOs operate under specific laws, such as NPOs structured as for-profit entities and educational legal entities governed under Badan Hukum Pendidikan, Law No. 20 of 2003 on National Education System Article 53. These types of NPOs are referred to as "societal organisations without legal entity status" (International Center for Not-for-Profit Law, 2023) and consist of at least three Indonesian citizens. If the organisation has a tiered structure, they are officially recognised upon the issuance of a registration certificate (Surat Keterangan Terdaftar) from the Ministry of Home Affairs; if not, they are recognised by the local government based on the organisation's location.

3.2 Tax Treatment

Thanneermalai (2022) highlighted that Malaysian NPOs can be exempted from tax if entitled to approval under Section 44(6) of the Income Tax Act 1967. Prior to applying for this status, NPOs must adhere to the general requirements established by the IRB: (1) The establishment must exist solely for charitable purposes; and (2) A minimum of 50% of the income, including donations received, must be allocated towards the approved target group of objectives during the assessment period. In addition, audited annual reports for the previous two years are required for these charitable organisations to qualify for tax-exempt status (Ghazali, 2017). NPOs that are eligible to apply for this exemption are CLBG, an organisation registered under the Societies Act 1966, a body corporate under the BHEUU and other recognised registrar bodies (Guidelines for Approval of Director General of Inland Revenue Under Subsection 44(6) of The Income Tax Act 1967, 2019).

Besides, these NPOs must be in operation for at least 24 months to ensure the planned objectives of the NPOs are carried out. Upon receipt of the approval, NPOs can enjoy exemption from income tax, and their donors are entitled to a deduction of their contributions in calculating aggregate incomes. According to section 44(6) of the Income Tax Act, charitable organisations in Malaysia may apply for tax-exempt status from the Inland Revenue Board (IRB), the governing body responsible for the tax.

As per Indonesian NPOs, the general rule is that they are subject to taxes. Public benefit status does not qualify NPOs in Indonesia for any tax benefits, and some tax deductions are available for charitable contributions such as natural disasters. The following types of income are also exempt: income used by an NPO to fund scholarships and income of an NPO dedicated to research and development or education that is reinvested in the organisation's operations as per the timing requirements of the income tax law (International Center for Not-for-Profit Law, 2023).

4. Comparative Analysis of Governance between Malaysia and Indonesia

Table 2. Comparative Analysis of NPOs in Malaysia and Indonesia

Criteria	NPOs in Malaysia	NPOs in Indonesia
Formation/Types of NPO	Varies, multiple regulations	Varies, governed mainly by the Law of Societal Organizations
Average Time Taken to register	Five days	27 days
Involvement in Policy Consultation	Less regular	Less regular
Source of Funding	More government grants	More foreign grants
Tax Incentives	Not limited to certain sectors	Limited to certain sectors
Individual Giving	Low	Low
Primary Accountability Mechanism	Financial Reporting	Financial Reporting
Funding Challenges	Insufficient funding hindering activities	Insufficient funding hindering activities
Reporting	Strict reporting requirements for NPOs registered with CCM	Strict reporting requirements for registered NPOs

Based on the discussion above, Table 2 summarized the comparative analysis between NPOs in Malaysia and Indonesia. They can choose the form of registration to set up the organisation. The existence of multiple regulations governing the non-profit sector reflects the fragmentation of laws governing the non-profit sector. Besides, based on the Doing Good Index 2022 by the Centre of Asian Philanthropy and Society, it can be observed that, on average, NPOs in Malaysia take five days to register as NPOs as compared to Indonesia, which takes around 27 days. Despite the longer days taken to establish NPOs in Indonesia, they are more well-versed in the regulations because most of them are generally governed by the Law on Societal Organisations (International Centre for Not-for-Profit Law, 2023). In addition, NPOs in Indonesia are more regularly involved in policy consultation than NPOs in Malaysia (Centre for Asian Philanthropy and Society, 2022).

NPOs in Indonesia receive more foreign funds as compared to NPOs in Malaysia (Centre for Asian Philanthropy and Society, 2022), as NPOs in Indonesia can be set up by foreign entities or foundations or through collaboration among Indonesian citizens and foreign nationals. Consequently, NPOs in Malaysia receive more government grants than NPOs in Indonesia (Centre for Asian Philanthropy and Society, 2022) because they rely more on government assistance than foreign support. It is essential for governments, organisations, and people to enhance support for NPOs by offering a conducive work environment, financial resources, equipment, and technical reporting assistance (Abiddin et al., 2022).

Tax exemptions and incentives signal the government's support for the relevant sector and organisation. In Malaysia, tax incentives for donors and recipients of philanthropic funds are not limited to specific sectors, unlike NPOs in Indonesia, which only limit tax incentives to certain sectors (Centre for Asian Philanthropy and Society, 2022). While tax incentives are available, both countries report low individual giving as donors prefer to donate directly to beneficiaries and religious institutions. Significantly, the main issue around NPOs is a lack of trust (Centre for Asian Philanthropy and Society, 2022; Jayasinghe, 2011; Marberg et al., 2016).

This situation may happen due to weaknesses in the regulatory environment and tax policies that govern the non-profit sector (Basri & Siti-Nabiha, 2010; Ebrahim, 2003; Shapiro et al., 2018). Also, lack of transparency and disclosure by NPOs and inconsistent reporting requirements may lead to an information gap between NPOs and stakeholders, thus triggering a trust deficit (Bellante et al., 2018; Ceptureanu et al., 2017; Jayasinghe, 2011; Owais et al., 2015; Shapiro et al., 2018).

Hence, NPOs are expected to discharge accountability since they are dependent on public donations and support. Ensuring accountability is critical for preserving the confidence of various stakeholders, such as governmental authorities, donors, community members, and regulators. Insufficient funding for NPOs has hindered their activities and organisational growth (Ijon, 2021). Most of the studies found that financial reporting is one of the primary mechanisms that are commonly used to maintain this accountability (Gordon et al., 2010; Roslan et al., 2017).

NPOs in Malaysia that have a formal registration with the Companies Commission of Malaysia (CCM) are required to abide by the CCM's reporting requirements. The standards require the preparation of financial statements, which are later to be audited to confirm compliance and accuracy. However, NPOs not registered with the CCM must adhere to less strict reporting rules, potentially leading to accountability and transparency issues within the sector.

Similarly, in Indonesia, insufficient reporting and transparency mechanisms have also been linked to money laundering and fraud scandals within the NPO sector in Indonesia (Sirait & Rangkuti, 2023). This highlights the importance of efficient reporting standards to minimise risks and uphold credibility within the sector.

In general, the application of reporting mechanisms is crucial to fostering transparency and accountability within the NPO sector. Through the implementation of standardised reporting requirements and consistent audits, NPOs can exhibit their dedication to the efficient management of public funds and maintain the confidence of their stakeholders.

5. Conclusion

NPOs play a central role in addressing social, economic, and environmental challenges in developing countries. Their activities encompass various sectors, including healthcare, education, poverty alleviation, and environmental conservation. However, the effective operation of NPOs relies heavily on the governance established by governments. In this regard, Malaysia and Indonesia serve as relevant case studies due to their shared characteristics as developing Southeast Asian countries.

Despite their proximity and similar cultural backgrounds, these nations exhibit distinct approaches to regulating and governing NPOs. Hence, this paper aims to analyse the governance of NPOs in Malaysia and Indonesia. Both Malaysia and Indonesia have enacted legislation to govern the establishment and operation of NPOs. The regulation and governance of NPOs in Malaysia and Indonesia reflect the diverse approaches adopted by developing countries in managing their non-profit sectors.

While both nations have established legal frameworks and regulatory bodies to oversee NPOs, challenges persist in ensuring transparency, accountability, and effectiveness. Effective governance and accountability mechanisms are essential for maintaining public trust and confidence in NPOs. Despite having regulatory bodies and laws to regulate NPOs in Malaysia and Indonesia, due to their reliance on the public's generosity, NPOs must be accountable for their use of public funds. It has been duly established that donations and funding are strongly correlated with good governance as they reflect closely with trust.

To foster trust, regulators may establish formal and structured reporting requirements that enhance the transparency and accountability of NPOs. Besides, collaboration is seen as a mechanism to gain trust (Shapiro et al., 2018). Thus, regulators could encourage and provide a platform for collaboration among NPOs and the public and private sectors, as modelled through the social public-private partnerships model.

In terms of theoretical contributions, this study establishes the comparative analysis of governance, specifically in terms of formation and tax treatment for NPOs in Malaysia and Indonesia. These insights represent variations of regulation between regulators within the country and across the countries. Hence, moving forward, the regulators may consider harmonisation of regulations to avoid confusion and ensure consistency in governance and monitoring of NPOs. Despite the challenges, such as limited funding and ambiguous reporting requirements, many NPOs have significantly impacted the beneficiaries and society. In view of SDG 2030, NPOs are on the right track to achieving those goals, provided they are focused and committed to delivering them.

Future research could explore the empirical evidence on the influence of governance structures and legal frameworks on the financial reporting practices of NPOs in Malaysia and Indonesia. This can enhance understanding of the relationship between governance and accounting practices in NPOs, improve organisational effectiveness and accountability, and guide the creation of evidence-based policies and guidelines for the sector in both countries.

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