

# CHAPTER I

## INTRODUCTION

### 1.1 Background of the Research

Organizations are established with specific visions and missions that must be achieved. There are different ways of classifying the existing organizations. Based on its sources of finances, there are 3 main classifications of organizations: for-profit organizations, governmental organizations, and not for profit organization (Hornngren et al., 2013). Regardless the type of organizations, there are two things that remain the same in terms of its importance: internal control and financial reporting. This is because the three type of organizations, use resources in its operations in order to accomplish their vision and mission (they have a common interest to ensure their vission and mission efficiently and effectively).

Internal control is critical for profit-driven organizations, as finance is essential for the organization's vitality (Shangxin, 2023). Conversely, non-profit entities, including social and religious organisations, frequently neglect internal control due to the predominantly voluntary nature of their activities, despite managing substantial social funds or public donations (Powell et al., 2015). As a result, there have been numerous cases of embezzlement of funds from non-profit organizations, causing the public to question the integrity of the funds they donate.

A study conducted by McKeever (2018) reported frauds involving approximately US\$40-45 billions in nonprofit organizations from 2007-2010, and these figures have surpassed US\$ 67 billion in 2013. Association of Certified Fraud Examiners (2024) has also reported that non-profit organizations accounted for 10 percent of the fraud and incurred an average loss of US\$76,000. One example of a problem that reflects the weakness of internal control systems in Indonesia can be seen in the case involving senior officials of Aksi Cepat Tanggap (ACT) Indonesia. This case indicates weaknesses in internal control mechanisms, particularly in relation to supervision, accountability, and transparency in the management of organizational funds. The lack of adequate internal controls has the potential to open up opportunities for misuse of organizational resources, thereby reducing public trust and undermining the main objectives of social organizations.

Similarly, Financial statements are crucial to an organization. Financial statements provide business organizations with an overview of their financial status during a specific time and act as a tool for decision-making evaluation. For non-profit organizations, financial statements provide financial information to entities that have contributed social aid cash. Financial statements for non-profit entities are governed by ISAK No. 35. They mandates the implementation of accrual accounting for non-profit entities. According to ISAK No. 35, a defining feature of non-profit entities is that their resources are derived from donors who do not anticipate any outcomes, incentives, or other commercial advantages (Indonesian Accounting Association, 2018).

The relationship between internal control and financial reporting is significant, as an effective internal control system guarantees the dependability, accuracy, and completeness of financial information (Altamuro & Beatty, 2010). Effective internal controls mitigate mistakes and fraud while ensuring adherence to financial reporting standards. The quality of financial reports is significantly affected by the efficacy of internal controls established within a business (Altamuro & Beatty, 2010).

Mosques are one example of a nonprofit organization, where their existence is not for profit, but for the public interest (Dewi, 2018). Mosques typically generate revenue through alms, which may include checks or cash, charitable contributions, event-specific donations, governmental support, and several other sources (Wan ali et al., 2025). Various sources of funds received by the mosque require proper financial management (Mohamed et al., 2014). Therefore, good internal control is essential to produce accurate and reliable mosque financial reports as a form of transparency and accountability for mosque income (Halim & Kusufi, 2014).

Previous research has examined internal control and financial reporting within mosques, emphasizing both the challenges faced and the importance of maintaining proper financial management in these religious institutions. Research by Sulaiman et al. (2008) indicates that, in general, state mosques in Malaysia have established sufficient internal control systems to safeguard their assets. However, there are still weaknesses in the internal control of these mosques, namely that special attention needs to be paid to the procedure for depositing funds in banks. Some state mosques do not deposit collections on the same day, or at least on the next working day. Some mosques even use these collections to finance other expenses before depositing the receipts.

In addition, research by Masrek et al. (2014) indicates that internal control practices in district mosques, overall, have adopted sound internal control elements. However, revenue collection and fund disbursement require considerable attention, particularly in terms of segregation of duties. Concerning the segregation of accounting responsibilities, the core principle is to separate three functions: authorization, recording, and custodial roles. A system of checks and balances is crucial to make embezzlement more difficult. Therefore, no individual should be assigned more than one function. In the case of district mosques in central Malaysia, the separation of duties related to counting money from its collection and the recording of entries in the cash book appears to be limited. Only five district mosques (38.46%) implement this separation.

In the context of Indonesia, recent research by Islamiyah (2020) on internal control in mosques in Java shows that variations in service activities affect the system of internal control implementation, where control environment is generally not based on strict formal regulations, even though SOPs based on ethical values have been used. This study also identifies five main accountability mechanisms, namely the use of communication media, performance evaluation, community participation and management commitment, the application of Sharia-based regulations and SOPs, and the preparation of activity reports and financial reports. These findings indicate that internal control practices contribute to increased mosque accountability, but compliance with PSAK 45 remains low due to limitations in the competence and understanding of management.

Furthermore, the study conducted by Alfarizi et al. (2024) investigates the implementation of ISAK 35 in the financial reporting practices of non-profit organizations, specifically aiming to assess the level of conformity between the financial statements of Al-Jihad Mosque and the provisions stipulated under ISAK 35. The analysis results demonstrate that Al-Jihad Mosque in Medan City has not completely adhered to the ISAK 35 standard in the preparation of its financial accounts. The mosque's financial records remain rudimentary, confined to fundamental documentation of cash inflows and outflows. This situation arises from the inadequate comprehension of the mosque's financial managers concerning the stipulations of ISAK 35, resulting in an incomplete execution of the recording and reporting process in alignment with the accounting standards pertinent to non-profit organizations. Furthermore, among the five components of financial statements required under ISAK 35, only three have been prepared in

accordance with the prescribed standards, namely the statement of financial position, the statement of profit or loss and other comprehensive income, and the notes to the financial statements. In contrast, the statement of changes in net assets and the statement of cash flows have not yet been presented in compliance with ISAK 35 requirements. These findings indicate that the implementation of ISAK 35 at Al-Jihad Mosque is still partial and requires further improvement, particularly through enhancing the financial managers' knowledge and competencies to ensure that financial reporting is conducted in line with the principles of accountability and transparency.

Another study addressing internal control was conducted by Zuhra and Maresti (2024), who analyzed the financial internal control practices of mosques in Indonesia. Their research focused on comparing differences in internal financial control based on management type, namely mosques administered by the government, religious organizations, and local communities. The findings indicate that, from the perspective of mosque managers, government-managed mosques demonstrate stronger internal financial control compared to those managed by religious organizations or community groups. Additionally, based on group classification, larger mosques tend to exhibit more robust internal control systems than smaller ones.

Furthermore, recent research by Wan Ali et al., (2025) contradicts existing studies. This research shows that internal control in mosques is still weak, especially in terms of financial documentation such as proof of payment, receipts, and asset records, which should serve as valid evidence of transactions. Many mosques also do not comply with daily cash deposit procedures, and only a small number perform bank reconciliations, resulting in less reliable financial reporting. Although religious institutions have attempted to oversee mosque governance, this oversight has not been optimal due to the absence of reporting and auditing requirements. The study advocates for the implementation of an integrated technological system to enhance the quality of documentation, reporting processes, and compliance with established regulatory standards. The findings further indicate that dependence on personal trust in the absence of a formalized system may undermine transparency and accountability. However, the study is subject to limitations, primarily due to insufficient data availability, as financial reports are prepared on a voluntary basis.

Drawing on prior studies, it can be inferred that a significant number of mosques have yet to effectively implement internal control principles and financial reporting practices in accordance with ISAK No. 35. This condition is influenced by several factors, including organizational

structure, the level of understanding of internal control systems, accounting knowledge, the adequacy of documentation, and the limited dissemination or socialization of ISAK 35. Collectively, these factors affect the effectiveness of both internal control implementation and the preparation of financial statements in line with ISAK 35 standards.

As the country with the largest Muslim population in the world, it is reasonable that Indonesia has a substantial number of mosques. Based on data from the Ministry of Religious Affairs' Mosque Information System (Simas), there are currently 706,727 mosques/prayer rooms in Indonesia. On a smaller scale, in the city of Padang, for example, there are approximately 1,500 mosques as of December 2025. There is still a large room for further research in the topic of internal control and financial reporting in the context of mosques.

The researcher is interested in researching the same topic in the context of West Sumatera. The reason was driven by the fraud case happened in Sheikh Ahmad Khatib Al-Minangkabawi Grand Mosque. The fraudulent use of donations funds at the Great Mosque of West Sumatra, revealed between 2013 and 2019, highlights significant deficiencies in the internal control mechanism governing mosque finances. Following the legal proceedings before the 2021 court ruling, it was established that a civil official, acting as the mosque treasurer, had misappropriated congregational donation funds and associated finances, culminating in a total loss of nearly Rp1.7 billion. The monies were intended for the mosque's operational and religious purposes.

Insufficient internal controls are particularly manifest in the ineffective execution of duty segregation, wherein a single individual possesses extensive responsibility over the management, storage, and disbursement of cash. The inadequate oversight and monitoring systems are evident in the prolonged duration of undetected embezzlement, suggesting that the functions of financial reporting, internal audit, and periodic oversight by pertinent parties were suboptimal. This condition signifies that the lack of cross-verification and a sufficient monitoring mechanism is a significant factor facilitating prolonged fund embezzlement.

## **1.2 Research Question**

Based on the background above, research question based on this study can be formulated as follows:

1. How are the internal control practiced by mosques in Padang City?

2. How are the implementation ISAK No. 35 by mosques in Padang City?

### **1.3 Research Objectives**

In accordance with the above research question, this study aims to:

1. Explore the internal control practiced by mosques in Padang City.
2. Explore the adoption of mosque financial reporting in accordance with ISAK No. 35 in Padang City.

### **1.4 Research Benefits**

Based on the research conducted, it is expected that the results of this study will provide the following benefits.

1. From a theoretical standpoint, this study is hoped to contribute to the advancement of more specific frameworks concerning internal control and financial reporting within non-profit organizations, particularly mosques. Furthermore, it seeks to deepen the understanding of internal control concepts and their practical application in mosque management, as well as to examine the implementation of financial reporting align with ISAK 35.
2. In practical terms, it is expected to assist mosque administrators in improving the effectiveness and efficiency of mosque management by applying internal control principles to increase the efficient use of funds and the quality of services provided to congregations.
3. From an academic perspective, this study is expected to contribute to the advancement of Islamic accounting knowledge and serve as a reference for future research in the field.
4. For the researcher, this study is expected to enhance insight and deepen understanding regarding the importance of internal control in mosques and the preparation of high-quality financial statements, as well as to fulfill the requirements for completing the final academic assignment.

### **1.5 Writing Systematic**

#### **CHAPTER I: INTRODUCTION**

This chapter presents the research background, outlines the problem formulation, and describes the objectives and significance of the study, as well as the overall structure of the research report.

## **CHAPTER II: LITERATURE REVIEW**

This chapter provides the theoretical framework that supports the interpretation of research findings, along with a review of prior studies that enrich the researcher's understanding in conducting the study.

## **CHAPTER III: RESEARCH METHODOLOGY**

The following section outlines the research design, describes the data utilized in the study, explains the methods of data collection, presents an overview of the research object, and details the techniques employed for data processing and analysis.

## **CHAPTER IV: RESULTS AND DISCUSSION**

This section presents information regarding mosques, as well as the forms of internal control systems and financial report practices implemented by mosques across the city of Padang.

## **CHAPTER V: CLOSING**

This chapter contains the conclusions, research limitations, and suggestions useful for future research.

