



**FINANCIAL MANAGEMENT PRACTICES AND
PERFORMANCES IN ZAKAT INSTITUTIONS**

BY

FATIMAH SAKEENAH BINTI ANUAR

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ABSTRACT

Since the 1990s, cases of misappropriation of funds in Western church institutions have been an issue. In 2012, such rumors spread to involve other religious organizations as well (The Star Daily, 2012; News Karnataka.com, 2014). Conditions are becoming more complex as people start to question and demand transparency and accountability. In Malaysia, rumors of mismanagement in *Zakat* institution have led to public demand for clarification as to how *Zakat* money is managed. Concerns regarding goal achievement of these organizations have been raised. Therefore, *Zakat* management has reflected these concerns by moving towards greater transparency in order to show their accountability. Thus, this study examines current practices of financial management and performances in *Zakat* institutions. The six elements of the Financial Management Accountability Index (FMAI), i.e. organizational management, budget, receipts, expenditures, assets and reporting were used as a benchmark. The suggestions of Said, Ghani, Zawawi and Yusuf (2012) and Berry, Parasuraman and Zeithaml (1994) were employed as indicators to examine performance. The study also attempted to find a relationship between financial performance index (FPI) and financial management practices (FMP). Further, the study employed the census sampling method for 14 *Zakat* institutions, and a sample of 140 employees and 140 customers. Empirical data were collected mainly through three sets of questionnaires. The data were coded and analyzed using Statistical Package for the Social Sciences (SPSS) software. Descriptive analysis and Correlation Bivariates were employed. The findings show that receipts, disbursements and asset management are the most crucial areas reflecting 'good' level practices by *Zakat* institutions. Furthermore, there is a positive relationship between financial management and performance. Thorough and detailed analysis found that certain indicators and practices also have a significant relationship. This research is significant as it gives *Zakat* institutions opportunities to find areas of improvement and determine particular areas which can be enhanced. The benchmark produced will help *Zakat* institutions discharge greater transparency and accountability towards the public in future. This will improve confidence and trust, as well as reduce confusion in Muslim society.

ملخص البحث

شاعت ظاهرة اختلاس الأموال في مؤسسة الكنيسة في الغرب منذ التسعينيات حتى أصبحت قضية، وفي عام ٢٠١٢م تفشت ظاهرة اختلاس الأموال في المؤسسات الدينية الأخرى. فبدأ عامة الناس بالتساؤل عن ذلك ومطالبة الصراحة والتوضيح والشفافية والأمانة في الإدارة المالية. وفي ماليزيا، أدى اختلاس الأموال في مؤسسات الزكاة إلى تساؤل عامة الشعب عن كيفية إدارة أموال الزكاة وصرفها. مما أثرت مخاوف كبيرة من تحقيق الأهداف المرجوة من قبل هذه المؤسسة. وقد اجتهدت إدارة مؤسسة الزكاة في الاعتماد على صراحة والشفافية كي يطمئن عامة الشعب إلى أمانتها في أداء واجباتها. لذا فإن هذا البحث يبحث عن كيفية الإدارة المالية في مؤسسة الزكاة وإنجازتها. فهناك ستة عناصر للإدارة المالية للنظام المحاسبي (FMAI)، وهي: الإدارة التنظيمية، والميزانية، والاستلام، والتسويق، والإدارة الملكية، والتقارير المستخدمة كمعايير. وهذه مقترحات من سعيد، وغني، وزواوي، ويوسف (٢٠١٢)، وبري، حيث تستخدم كدليل في فحص الإنجازات. كما أن هذا البحث يبحث عن علاقة بين الأداء المالي (FPI) وعملية الإدارة المالية (FMP). واستخدم هذا البحث طريقة تعداد أخذ العينات، ومجتمع البحث عبارة عن أربعة عشر مؤسسة زكاة، أما عينة البحث فتتكون من ١٤٠ عاملا، و ١٤٠ عميلا. وقد تم جمع المعلومات أو البيانات التجريبية عبر ثلاث مجموعات من الاستبيانات الاستطلاعية، وقد تم تحليل جميع المعلومات بواسطة "حزمة البرامج الإحصائية للعلوم الاجتماعية (SPSS)". ونهج البحث المنهج الوصفي "التحليل الوصفي والارتباط المتنوعة". وأشارت نتائج البحث إلى أن الإستلام، والإنفاق، والإدارة الملكية تعد من أهم الأمور في الإدارة المالية. لحصولها على مستوى "جيد" من مؤسسات الزكاة. إضافة إلى ذلك، وجد البحث أن هناك علاقة إيجابية بين الإدارة المالية و الإنجاز. كما أشارت نتيجة التحليل الدقيق إلى أن الدليل والممارسة لهما علاقة مهمة. فهذا البحث يعد مهما جدا لأنه يرشد مؤسسات الزكاة إلى وسائل عدة لتحسين ممارستها في إدارة أموال الزكاة، كما أن معايير الإنجاز الناتجة من البحث ستؤدي دورا مهما في إصلاح عملية الإدارة المالية، والشفافية، والأمانة لخدمة المسلمين المستقبلا. مما يؤدي إلى زيادة الثقة بالمؤسسات الزكاة ويزيل الشكوك والشبهات من قلوب المسلمين.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion; it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science in Accounting.

.....
Norhayati Mohd Alwi
Supervisor

.....
Noraini Mohd Ariffin
Co-Supervisor

I certify that I have read this study and that in my opinion; it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science in Accounting.

.....
Siti Alawiah Siraj
Examiner

.....
Ros Aniza Mohd Shariff
Examiner

This dissertation was submitted to the Department of Accounting and is accepted as a fulfilment of the requirements for the degree of Master of Science in Accounting.

.....
Noraini Mohd Ariffin
Head, Department of Accounting

This dissertation was submitted to the Kulliyah of Economics and Management Sciences and is accepted as a fulfilment of the requirements for the degree of Master of Science in Accounting.

.....
Maliah Sulaiman
Dean, Kulliyah of Economics
and Management Sciences

DECLARATION

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Fatimah Sakeenah binti Anuar

Signature.....

Date

INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA

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.....
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LIST OF ABBREVIATIONS

A	Assurance
AM	Asset management
BG	Budgeting
CEO	Chief executive officer
CPM	Composite performance measurement
CSI	Customer satisfaction performance index
DB	Distribution and disbursements
E	Empathy
ESI	Employee satisfaction performance index
F	Financial benefit
FI	Financial index
FMAI	Financial Management Accountability Index
FMP	Financial Management Practices
FPI	Financial performance index
JAIP	Jabatan Agama Islam Pahang
JAKIM	Federal Government of Islamic Development Malaysia
JAWHAR	Department of Awqaf, <i>Zakat</i> and Haji
K	Knowledge advancement
KWSP	Employees Provident Fund
LZS	Lembaga <i>Zakat</i> Selangor

MAIDAM	Majlis Agama Islam dan Adat Melayu Terengganu
MAIJ	Majlis Agama Islam Negeri Johor
MAIK	Majlis Agama Islam Negeri Kedah Darul Aman
MAIK	Majlis Agama Islam dan Adat Melayu Kelantan
MAIM	Majlis Agama Islam Melaka
MAIN	Majlis Agama Islam Negeri
MAINS	Majlis Agama Islam Negeri Sembilan
MAIP	Majlis Agama Islam dan Adat Istiadat Melayu Perlis
MAIPK	Majlis Agama Islam dan Adat Melayu Perak
MAIS	Majlis Agama Islam Selangor
MAIS	Majlis Agama Islam Sarawak
MAMPU	Malaysian Administrative Modernisation and Management Planning Unit
MASB	Malaysian Accounting Standard Board
MUIP	Majlis Ugama Islam dan Adat Resam Melayu Pahang
MUIS	Majlis Ugama Islam Sabah
MAIWP	Majlis Agama Islam Wilayah Persekutuan
N	Non-financial benefit
NAD	National Audit Department
OM	Organizational management
PPZ	Pusat Pungutan <i>Zakat</i>
PUZ	Pusat Urusan <i>Zakat</i>
PZM	Pusat <i>Zakat</i> Melaka
PZNS	Pusat <i>Zakat</i> Negeri Sembilan

PZS	Pusat <i>Zakat</i> Selangor
PZS	Pusat <i>Zakat</i> Sabah
R	Reliability
RP	Responsiveness
RPT	Reporting
RT	Collection and receipt
SERVQUAL	Service Quality
SIRC	State Islamic Religious Council
SPSS	Statistical Package for the Social Science
T	Tangibles
W	Working environment
ZI	<i>Zakat</i> institution

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

The *Zakat* system is a holistic system derived from Islam, aiming for better spiritual and socio-economic states for Muslims. The system tries to help its eight beneficiaries (the poor, the needy, '*Amil, fi sabilillah, muallaf*, the slave who wants to free himself, the person in debt, and the traveller) economically and socially by improving the relationship and strengthening the brotherhood between rich and poor. According to Majid (2003), discussion on *Zakat* appears in more than forty verses in the Qur'an, one hundred and seventy (170) *hadith* and in the works of many acknowledged scholars, indicating the significance of *Zakat*. The word *Zakat* came from the root word '*Zaka*' which means cleanliness, growth, praise and blessing (Qardawi, 1980).

Zakat's functions are reflected in its literal definitions which are to purify Muslims' souls and wealth and prosperity, stimulates and strengthen the socio-economy by enhancing productivity and employment rates, providing a type of 'social insurance' system as well as addressing problems such as begging in Muslim states. In addition, *Zakat* is also intended to spread and preserve Islamic *Shari'ah* as well as to defend the Muslim community from any type of harm (Qardawi, 1980).

Zakat institutions (*ZIs* thereafter) have played a vital and critical role in Muslim societies since the early years of Islam. These institutions carry out a very important mission in achieving the objective of *Zakat* system. *ZIs* operate and administer the collection and distribution functions of *Zakat* money. They also help in

promoting *Zakat* as a part of religious and social obligations of each Muslim individual. Theoretically, *ZIs* support the organization of *Zakat* system so that it will have a great impact on Muslims society and economy.

As the *Zakat* system holds sacred and deep objectives, the role of *ZIs* are crucial and significant. The management of *ZIs* is tightly bound to its sources of funding, namely, *Zakat* payers and the wider public, as the institutions are characterized as non-profit organizations. Thus, public confidence and institutional reputation have become key factors for these organizations' survival and growth. A good reputation and public confidence enable *ZIs* to drive *Zakat* system to its full potential. On the other hand, a bad reputation and public doubt will hinder *ZIs* in operating at their fullest and best. In addition, all actions or decisions by *ZIs* are subject to accountability to the real owner of its wealth, Allah. In total, *ZIs* need to observe and show their accountability in handling *amanah* to Allah the Real Owner, *Zakat* payers, *Zakat* beneficiaries and the wider public.

In this challenging world, Malaysia is advancing to become a developed nation. From its current status as a developing country, Malaysia has only five years to reach its aim of becoming a developed country in year 2020. Dato' Sri Dr Mahathir Mohamad (1991) clearly stated that Malaysia was going forward to become a fully developed country such as the United Kingdom, Holland, Sweden and Japan.

“There can be no fully developed Malaysia until we have finally overcome the nine central strategic challenges that have confronted us from the moment of our birth as an independent nation.” Among the nine challenges mentioned in his paper, three of the challenges demand the effective roles of *Zakat* system and *ZIs* in Malaysia. These three challenges are:

1. To establish a fully caring society, in which the welfare of the people will revolve not around the state or the individual but around a strong and resilient family.
2. To ensure an economically just society. This is a society in which there is a fair and equitable distribution of the wealth of the nation, in which there is full partnership in economic progress. Such a society cannot be in place so long as there is the identification of race with economic function, and the identification of economic backwardness with race.
3. To establish a prosperous society, with an economy that is fully competitive, dynamic, robust and resilient.

In overcoming these challenges, the role of *ZIs* are crucial in ensuring the optimal roles of *Zakat* system. *Zakat* system has a great potential to override these challenges. However, good management and administration of the *Zakat* system demand professional standards in accounting and auditing practices in *ZIs*. Historically, in the era of Umayyad and Abbasid, proper accounting and auditing were emphasized as very important factors to enable institutions to fulfill their accountability (Abdul Aziz, Mohd Jamil, Ismail and Abdul Rahman, 2013). History has also shown the success of the *Zakat* system in eradicating poverty and generating a perfect social system during the time of Caliph Umar Abdul Aziz. Learned from these lessons, *ZIs* in Malaysia should aim towards becoming proactive tools in supporting the country's Vision 2020.

1.2 ZAKAT INSTITUTIONS IN MALAYSIA

In Malaysia, there are fourteen *ZIs* in fourteen states. Each of them has its own structure and management style. The *Zakat* system is part of religious matters, which

fall under the authority of the Islamic Councils. According to the Constitution of Malaysia, rather than the federal government, the state government has the authority and control over religious institutions in their own state. All religious matters are under the control of each Administration Enactment for each state and the Act for the Federal Territory (Said, Ghani, Zawawi and Yusuf, 2012; Kaslam, 2007). Thus, federal government has no authority to manage, collect or distribute *Zakat* in states. As a result, management styles in *ZIs* vary and depend on each individual state (Amran and Auzair, 2011); thus, the State Islamic Religious Councils (SIRC) which represent each state have authority over *ZIs*, but this authority is limited to their own locality and boundary. According to the Federal Constitution, Schedule 9, List 2, Article 1:

Islamic matters (including the management of *Zakat*) are under the jurisdiction of these 14 states managed by State Islamic Religious Council.

In states such as Kedah, Perak, Selangor, Kelantan, Terengganu, Pahang and Johor, the *Sultan* is the head of the Islamic religion. The *Yang Di Pertuan Agong* is the head of the religion in Pulau Pinang, Sabah, Sarawak, Melaka and Wilayah Persekutuan. The *Raja* is the highest authority in Perlis and the *Yang Di Pertuan Besar* leads in Negeri Sembilan. The SIRC is appointed, plays its role as advisor to the rulers and each state has its own Islamic legislation (Yaacob, 2006; Kamil, 2002 in Md. Hussain, nd). As a result, there is lack of uniformity among *ZIs* with regard to accountability and transparency in reporting their finances. They are not centrally regulated and their performances are not centrally supervised.

The Federal Government of Islamic Development of Malaysia (JAKIM) coordinates Islamic affairs nationally. JAKIM is involved in drafting and streamlining

Islamic laws and regulation and coordinating their implementation at the state level. A central unit or department, called the Department of Awqaf, Zakat and Haji (JAWHAR), has also been formed under the Prime Minister's department. The unit functions as a central department to which all *ZIs* in Malaysia can refer in order to make an effort towards better management. One unit that gathers all *ZIs* in Malaysia is the '*Majlis Agama Islam Negeri*' (MAIN). The unit has organized several programs in order for sharing ideas on *Zakat* management issues. However, their functions in the *Zakat* system remain minimal for the time being.

ZIs in Malaysia vary in their characteristics in terms of their organizational structure, sources of funds, types of *Zakat* collected, methods of *Zakat* collection and distribution, accounting standard practice and documents published for reporting.

1.3 PROBLEM STATEMENT

Mismanagement in non-profit and religious organizations has been an issue since the 1990s. Since then, the public's concern about the effectiveness, accountabilities and transparency in such organizations has been growing. *ZIs* as part of non-profit and religious organizations have also faced various rumours and perceptions. As reported in Kashmir Observer (2013), *ZIs* in some regions have been seen as an obstacle between *Zakat* payers and the needy and become the hindrance of proper application of *Zakat* funds. This report highlighted that the priorities of distributing *Zakat* funds have been overridden by the administration and management expenses. This became worse when the political motives intervened in the process (The Express Tribune, 2012). Improper mechanisms for identifying the beneficiaries and their level of priority also become a factor in the lack of effectiveness in *ZIs*. Furthermore, non-availability of accurate data of *Zakat* payers and beneficiaries has also been

considered as a source of corruption in *Zakat* system (The Express Tribune, 2012). Many prior studies have tested the effectiveness of *ZIs*' operations and management. In Mohd Noor, Abdul Rasool, Md Yusof, Ali and Abdul Rahman (2015), issues of fairness, appropriateness, channels, and methods of *Zakat* distributions have been discussed. The distribution of *Zakat* funds are highly dependent on the trend of paying *Zakat* and the distribution budget proposed by SIRC's.

Prior studies found that *ZIs* were not managing the *Zakat* funds in their custody efficiently. Abdul Halim, Musa, Mujaini, Hasan and Shawal (2005) and Ahmad and Ma'in (2014) discovered that *ZIs* were lagging behind in both the collection and distribution of resources, particularly in terms of technical efficiency. Ali (1990), Azizah, Musa, Ayob, Norzehan & Mohd Sayidi Mokhtar (2005), Hasan (2005), Eri (2004), Halidan (2006), Ismail (2006), Jamaliah (2004), Kamil (2005), Nur Barizah et al. (2006), Nur Fadilah et al (2006), Zainal Abidin (2006) and Ahmad Shahir and Adibah (2010) in their studies support these issues as well.

Furthermore, the credibility of *ZIs* in managing *Zakat* fund also been questioned. This is due to the findings of prior studies such as Syed Yusuf, Mastuki and Din (2011), Abdul Halim et al. (2005), Ahmad and Ma'in (2014), Azizah, Musa, Ayob, Norzehan and Mohd Saiyidi Mokhtar (2005) and Jamaliah (2004), discover there are lack of management accounting knowledge among *Zakat* practitioners.

Thus, public perception on the inefficiencies are pronounced here as distribution shows less efficiencies than collection. Besides, the exposure of accounting knowledge among *Zakat* practitioners portrays the professionalism of *ZIs* in managing *Zakat* funds. It is confirmed by the finding by Kamil (2005), Hasan (2005) and Ahmad Shahir and Adibah (2010) that most *Zakat* payers and potential *Zakat* payers were doubtful on the credibility of *Zakat* practitioners. Due to that, some

might choose to pay *Zakat* informally or not paying *Zakat* as supposed. All of the issues mentioned explained the perception of *Zakat* payers, beneficiaries and Muslim public.

ZIs in Malaysia have very unique features as it is legislated separately by each state authority. They are also different in terms of organizational structure. Some are government statutory bodies, corporatized and privatized. Their accounting standards vary as well. Some *ZIs* follow Treasury rulings, Malaysian Accounting Standard Board (MASB), Companies' Act, Financial Best Practice from SIRC and National Procedure for Corporate Accounting. Even some *ZIs* collect dissimilar types of *Zakat*. For example, some *ZIs* do not collect *Zakat* from KWSP. Even, in reporting and disclosing information, only three *ZIs* distribute annual report only, four *ZIs* distribute annual report and bulletins only and two (2) *ZIs* disseminate bulletins and flyers. These create inconsistencies in financial management and reporting and thus comparison of performances are hardly able to compare.

Due to the flexibility allowed in managing *ZIs* in this country, control from inside organizations has been a crucial factor in ensuring appropriate management and accountability practices. Weak control may invite unpleasant situations such as intentional or unintentional mismanagement, scandals or doubts among stakeholders. Several examples have arisen in the past and been found in yearly reports from the Malaysian Auditor General and Public Accounts Committee showing that considerable mismanagement occurs in government agencies or non-profit institutions such as the Pilgrimage Fund, the Employee Provident Fund and the Farmers' Land Development Authority (Bakar & Saleh, 2011).

Therefore, in order to have legitimacy for their existence and functions, *ZIs* must observe best management practices in their operations. In addition, as Amran

and Auzair (2011) state, because the trust or *amanah* are given to *ZIs*, management effectiveness has always been a subject of interest among stakeholders. This is where the primary subject of how important the financial management best practices adopted in *ZIs* are.

All these differences among *ZIs* are the major matters of concern which make the accountability and financial management practices become the key concern here. Public societies as a major source of fund in these institutions and as beneficiaries of those funds have their own interest on these issues. They insist on information regarding how their paid money have been managed. They want to know the performance of these institutions to ensure these institutions operate within the accountability and transparency framework. These are the reason why this study should be conducted.

1.4 OBJECTIVES OF THE STUDY

The study is inspired to realize these four objectives as follows:

1. To identify the current implementation level of FMPs in *ZIs*.
2. To highlight the significant weaknesses in the implementation of FMPs in *ZIs*.
3. To test the efficiencies of *ZIs* from the perspective of management, employees and customers.
4. To ascertain the relationship exists between FMP and FPI in *ZIs*.

As the study concerned on the FMPs of *ZIs*, six areas have been examined:

1. Organizational management
2. Management of *Zakat* collection and other receipts
3. Management of *Zakat* distribution and other expenditures

4. Management of assets
5. Management of budgeting
6. Management of reporting

These six areas are among the crucial part in financial management introduced by National Audit Department in Malaysia (Bakar & Ismail, 2010). On the other hand, the efficiencies of *ZIs* are based on three perspectives or dimension proposed by Said et al. (2012). They are:

1. Financial performance index (FPI),
2. Employee satisfaction index (ESI) and
3. Customer satisfaction index (CSI).

1.5 RESEARCH QUESTIONS

Below are the research questions for the study:

1. What is the level of current implementation of FMPs in *ZIs*?
2. What are the significant weaknesses in the implementation of FMPs in *ZIs*?
3. What are the efficiency levels of *ZIs* from three different perspectives? i.e management, employees and customers.
4. What is the relationship between FMP and FPI in *ZIs*?

Six financial management practices were examined and the financial management practices were compared to its performance in order to reveal the best *ZI* practices. Outcome of this study are the potential areas for improvements in practices and performances. In this study, 'Financial Management Benchmark' and 'Performance Measurements for *ZIs*' are produced as tools in examining the financial management practices and performances in *ZIs*. Common financial management practices will