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THE FINANCIAL CONTROL PRACTICES OF
ZAKĀT INSTITUTIONS IN STATE ISLAMIC
RELIGIOUS COUNCIL IN MALAYSIA

BY

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ABSTRACT

In the last two decades, financial scandals and mismanagement of religious organizations resources have overwhelmed on the western arena. Complaints from the churches have increased and the reputation of the religious centres has decreased. This has attracted the attention of many researchers to explore the reality in the world of religious organization systems. Even though, no such financial misappropriations have been reported in the Islamic religious nonprofit organizations, it has been raised the question of whether Islamic religious organizations are experiencing similar circumstance (Maliah, 2007). This study is an exploratory in nature which aims to explore the financial control practices of Malaysian zakat institutions. There are four financial control procedures emphasized in the study: control environment, control over receipts, control over disbursements and reporting control. A questionnaire survey was conducted to collect data. The questionnaires were sent to the financial staff and the manager and/or deputy managers of the 14 *zakāt* institutions in Malaysia. Of the fourteen *zakāt* institutions, ten (10) *zakāt* institutions cooperated with 41 respondents. The results of study show that financial control practices of *zakāt* institutions in Malaysia is generally good. Control over disbursement procedures and reporting system have scored the highest level of practice compared to the other two control procedures, control environment and control over receipts. Although the strengths of control procedures are in different levels, an overall assessment shows that Malaysian *Zakāt* Institutions have good financial control practices.

ملخص البحث

في العقدين الماضيين هيمنت قضايا الفساد المالي وسوء الإدارة في المؤسسات الدينية الخيرية في المحافل الدولية وخاصة في الدول الغربية. إرتفعت شكاوى المتعاملين مع المؤسسات الدينية الخيرية, خاصة مجامع الكنائس المسيحية, وإنخفضت سمعتها المالية والإدارية لدي اتباعها. اجتذبت تلك القضايا في إنتباه الباحثين والأكاديمين في دراسة الوضع المالي وممارسات الرقابية المالية في المؤسسات الدينية الخيرية في الغرب. رغم أنه لا يوجد بحوث أو دراسات سابقة أعطت الإهتمام حول الوضع المالي وممارسات الرقابية المالية في المؤسسات الخيرية في العالم الإسلامي إلا أنه زادت الشكوك والأسئلة فيما إذا كان وضع تلك المؤسسات المالي وممارسات رقابيتها المالية يختلف عن نتائج تلك الدراسات التي أجريت في المؤسسات الدينية الخيرية في الغرب. لذلك تهدف هذه الدراسة التي بطبيعتها دراسة اكتشافية في مدي وجود انظمة وممارسات رقابية علي الموارد المالية في مؤسسات الزكاة في ماليزيا. تسعى هذه الدراسة في إختبار أربعة وسائل رقابية مالية هي: مدي وجود بيئة رقابية, مدي ممارسة الرقابة المالية على المقبوضات, مدي ممارسة الرقابة المالية على المدفوعات, مدي ممارسة الرقابة المالية على التقارير المالية والإفصاح. لتحقيق أهداف الدراسة تم إستخدام إستبان لجمع البيانات. ارسل الإستبيان إلى كل من المدراء والمسؤولين الماليين والمحاسبين والمراجعين في مؤسسات الزكاة في الولايات الأربعة عشر التي تتكون منها مملكة ماليزيا. أظهرت نتائج الدراسة بأن ممارسات الرقابة المالية كانت قوية بشكل عام. ممارسات الرقابة المالية على البيئة الرقابية وممارسات الرقابة على المدفوعات كان أفضل بمقارنتها مع ممارسة الرقابة على المقبوضات وعلى نظام التقارير والإفصاح.

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 dissertation for the degree of Master of Science in Accounting.

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DECLARATION

I hereby declare that this dissertation is result of my own investigation, 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.

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**THE FINANCIAL CONTROL PRACTICES OF *ZAKĀT*
INSTITUTIONS IN STATE ISLAMIC RELIGIOUS
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LIST OF ABBREVIATIONS

CEP	Control environment procedures
CORP	Control over receipts procedures
CODP	Control over disbursements procedures
COFR	Control over financial reporting
e.g.	(exempligratia): for example
et al.	(et alia): and others
i.e.	(id est): that is
NPOs	Nonprofit Organizations
MASB	Malaysian Accounting Standards Board
MZIs	Malaysian Zakat Institutions
PBUH	Peace and Blessing be Upon Him (the Prophet)
RA	RadiyaLLahu Anhu
RNPOs	Religious Nonprofit Organizations
RM	Malaysian Ringgit
SAW	Salla-Laahu Allaihi Wassalam
SIRC	State Islamic Religious Council
SWT	Subhanahu Wata'ala

CHAPTER 1

INTRODUCTION AND BACKGROUND

1.0 INTRODUCTION

In the last two decades, financial scandals and mismanagement of religious organizations resources have overwhelmed the western arena. Complaints from the churches have increased and the reputation of the religious centers has decreased (Edwards, 1990). This has attracted attention of many researchers to explore the reality in the world of religious organization leaders. Similarly, the financial management of religious organizations is dominated by conditions of resource scarcity and because of that religious organizations are heavily dependent on the support of the donors and members (Lightbody, 2000). Due to that, religious nonprofit organizations frequently face enormous deficiencies to finance their activity, which in turn hinders the achievement of their communal missions.

Those mentioned circumstances have raised the concerns of the financial control management of religious organizations and attracted the attention of researchers to conduct studies in this area, specifically in the Western religious organizations (Wooten et al. 2003).

In the case of Islamic religious organization, it is not known much about its financial performance. Even though there have been no reports of financial scandals in Islamic religious organizations, nowadays there is an increasing concern of whether these organizations are experiencing similar deficiencies as other religious institutions in the West (Maliah Sulaiman, 2007).

Although there are quite a number of studies in the areas of Islamic religious organizations, they mainly emphasize on the general administration and performance measurement of Islamic religious organizations such as *waqf* and *zakāt* institutions (for example; Bakar, 1998; and Abdul Rahman et al, 1998). Resources management of *zakāt* institution is more important than any other institution as it involves a religious matter which concerns every Muslim. Additionally, *zakāt* institution's role is not only financial but also, besides its socio-economic impacts, affects the spiritual aspect of the society. Therefore, the failure of this institution may have an effect on not only the economical aspect of the *ummah*, but also on the spiritual and performance of their *ibadāh*. Meanwhile, *zakāt* institution's financial control and its effective management is deemed to be more crucial one than any other financial institutions.

In Malaysia, *zakāt* institution is a division of the State Islamic Religious Council (SIRC), and it is described as a societal institution that is perceived as a publicly-owned institution. It is established to handle and manage *zakāt* funds, collections and disbursements (Bakar, 1998). It falls under the State Islamic Religious Council which is assigned to administer all religious affairs in Malaysia. In spite of *zakāt's* importance in the Muslim society, there are very few studies about *zakāt* administration. For instance, Osman and A. Hamid, (n.d.), Jamaliah, (2004), and Nazifah Mustapha (2007) have discussed the current inefficiency of management system and performance of *zakāt* institutions in Malaysia, which is attributed to the shortage of staff expert.

Even though the available literature in *zakāt* institutions did not give such considerations to the area of financial control of *zakāt* institutions, the general evidence shows that *zakāt* institutions do not display sound financial management

practices (Abdul Latif, 1998, and Osman and A. Hamid, n.d.). This scenario can create dissatisfaction among the society with regard to zakāt institutions ability to meet with the religious and social needs of the Muslim community (Osman and A. Hamid, n.d.).

Financial control is the heart of financial accountability, which no institution can survive and achieve its social goals without. However, since there are no an empirical studies regarding this matter, the focal point of this study is to explore the financial control practices of *zakāt* institutions in Malaysia.

1.1 MOTIVATION OF THE STUDY

A review of the literature about the Western religious organizations' practices shows financial scandals and mismanagement of the public wealth associated with the management of those organizations. The majority of these studies show the inadequacy of financial management practices, poor accounting systems and lack of internal control over the financial resources in the western churches (for example, Holder, 1987; Laughlin, 1988, 1990; Booth, 1993; Flesher et al, 1999; Lightbody, 2000; Keating & Frumkin, 2003; Wooten et al, 2003; and Jacobs, 2005).

Although there are no financial scandals reports or studies in Islamic religious organizations, the general concern of whether these institutions experience a similar situation has been raised (Abdul Latif, 1998, Osman and A. Hamid, n.d.). There is quite a number of studies on Islamic religious organizations, specifically in the areas of *zakāt* collection and disbursement management, *zakāt* performance and *zakāt* administration in general.

These studies show performance weaknesses, inefficiency of collection and disbursement management, and general weaknesses of resource administration in religious organizations, particularly *zakāt* institutions (Osman and A. Hamid, n.d.;

Mohd Daud, 1998; Abdul Latif, 1998; Alawiah, 2004; Zain, 2005; and Nazifah Mustapha, 2007).

According to the area of financial management practices, there are very few studies which mainly focus on the accounting practices and internal control. For instance, Abdul Rahman and Goddard (1998) found, in a study conducted to examine whether the sacred-secular divide scenario exists in the Islamic religious organization in Malaysia, that generally accounting is marginalized. Although this study does not emphasize specific types of institution, such as *zakāt* institution, it is worthy evidence that accounting in religious institutions' atmosphere may not have such importance compared to the other non-religious organizations, such as profit seeking organizations.

However, the majority of these literatures, whether in western or Islamic religious organizations, show poor general administration of funds, inadequacy of financial accountability practices, inappropriateness of accounting systems and poor financial control, and finally insufficient financial disclosure and reporting. Therefore, this study may be uniquely the starting point in this area. As a result, the researcher is motivated to explore the financial control practices of *zakāt* institutions in Malaysia.

1.2 RESEARCH OBJECTIVES AND RESEARCH QUESTIONS

This study aims to explore, understand and document the current state of financial control procedures that are practiced by *Zakāt* Institutions in State Islamic Religious Council (SIRC) in Malaysia. Therefore, this study aims:

1. To have a better understanding of the financial control procedures developed and practiced by the *Zakāt* Institutions in State Islamic Religious Council (SIRC) in Malaysia.

2. To explore the financial control practices in the organizational context of *Zakāt* Institutions in State Islamic Religious Council (SIRC) in Malaysia with special focus on the four financial control procedures of:
 - a) Control environment
 - b) Control over receipts
 - c) Control over disbursements, and
 - d) Financial reporting.

The main objective of the study attempts to identify whether *zakāt* institutions in Malaysia have put into practice an effective financial control procedures, through implementing rational internal control system over *zakāt* collections and disbursements, and financial reporting. Unlike profit organizations, nonprofit and religious organizations are incorporated entities where ownership rests with the members of organization. Flesher et al. (1999) state that the existence of the unique characteristics, which is the absence of ownership, makes the resources of the nonprofit and religious organizations vulnerable to mismanagement, because managers might not consider themselves as accountable to their donors as they would to owners. Therefore, since *zakāt* institutions mainly depend on the *zakāt* funds paid by the public (i.e. *zakāt* payers) its financial system may be susceptible for the same situation found in the western religious organizations.

The main objective of the Islamic religious organizations, such as the collection and disbursement of *zakāt*, is to aid Muslims discharging their religious financial obligation and accomplishing their *amanah* or trust (Shahul, 2000) by adhering to *Allah*'s commandments during *zakāt* payment. Therefore, the management of *zakāt* institution has the responsibility to maintain an effective system to achieve its fiduciary contract.

To examine whether zakāt institutions put into practice an adequate financial management system, the study will shed light on the areas of internal control over collection and disbursement and financial reporting practices. A financial control system include, whether accounting records are kept properly, separation of custody duties from the record keeping duties of the resources, and whether *zakāt* institutions provide financial information to the *zakāt* payers and other stakeholders. In addition, the aim is to find out whether zakah institutions' management undertakes budgetary and financial planning and control, and whether they properly comply with those plans to achieve their social objectives.

From the abovementioned objectives of the study, the researcher derives the following question.

RQ: To what extent are financial control procedures developed and practiced by *Zakāt* Institutions in State Islamic Religious Council (SIRC) in Malaysia? Specifically, the financial control procedures are:

- a) Control environment
- b) Control over collection
- c) Control over disbursement, and
- d) Financial reporting

This question is designed to answer the objectives of the study which is to explore the extent of financial control procedures practices in *Zakāt* Institutions in Malaysia. It is divided into four parts, namely: control environment, control over receipts, control over disbursements and financial reporting. These four procedures are intended to answer the four parts of the research objective.

1.3 SIGNIFICANCE OF THE STUDY

Financial resource preservation in religious organizations is a fiduciary responsibility, which requires a self-regulation and voluntary oversight work of entrusted public resources (Gibelman and Gelman, 2004). Therefore the importance of these religious organizations' position in society and their role in contributing to the community development has attracted the attention of many researchers to explore and investigate, generally, the management practices and the financial accountability practices of such organizations specifically. For instance, Holder (1987), Laughlin (1990), Booth (1993), Abdul Rahman and Goddard (1998, 2003) Flesher et al. (1999), Lightbody (2000), Kluvers (2001), Wooten et al. (2003), and others have discussed intensely the financial accountability, implementation of accounting systems, internal control, and financial disclosure of nonprofit and religious organizations.

As far as religious organizations are concerned, the concept of sacred and secular divide dominates the majority of the existing literature (Booth, 1993). Laughlin (1988) highlighted that accounting is considered antithetical to religious values and contrary to the sacred values and orientation of the religious organizations. Similarly, Booth (1993) explored the same themes of Laughlin (1988) in his study and found that the perception of sacred-secular divide existed in such religious organizations.

The literature found that, in Western religious organizations, accounting systems, finance and financial accountability matters were considered as secular and secondary, which should not be involved in the sacred affairs of religious organizations (Laughlin, 1990).

However, the majority of these studies emphasized on the non-Islamic religious organizations (i.e. churches), and its accountability and financial management practices, with a focus on internal control, budgeting and accounting practices (Abdul Rahman & Goddard, 1998). Even though there is a considerable number of studies that emphasize on the administration of *zakāt* institutions, a very few of them concern the financial management practices of Islamic religious organizations (for example, Khan, 1990; Abdul Rahman & Goddard, 1998, 2003; Jamaliah, 2004, Siti Alawiah, 2004; and Zain, 2005).

These studies, whether in western religious or in Islamic religious organizations, show the inadequacy of financial management practices, poor accounting systems, poor financial control and inefficient financial disclosure. As a result, there is a dearth of empirical studies on the accounting and financial accountability practices of Islamic religious organizations in general, and *zakāt* institutions, in particular. Thus, in this study the researcher attempts to explore financial control practices and how such Islamic religious organizations, particularly *zakāt* institutions, may differ from the situations found in the western religious institutions.

A thorough analysis of the results will provide a better understanding of the state of financial control practices of *zakāt* institutions. From the analyses of the results, it is hoped that the findings of this study will serve as a model for *zakāt* institutions in the Muslim world.

1.4 ORGANIZATION OF THE CHAPTERS

The thesis consists of six chapters. Firstly, the thesis starts with the introductory chapter. This chapter provides a brief explanation of the background, objectives and research questions, motivation and brief description of the significance of the study.

Chapter two reviews the literature on accountability in the mainstream of western religious institutions, and an Islamic view was also provided. It highlights the practices of religious institutions in the western world (specifically the church). The financial management of nonprofit organizations is also addressed in this chapter. In addition, definition and importance of financial control, the control over the receipts and disbursements and financial reporting are discussed.

Chapter three introduces the definition and the role of *zakāt* in the Muslim society. Then, it discusses and reviews the management and administration mechanism that concerned *zakāt* institutions generally in the Muslim world, and particularly in Malaysia. Furthermore, it provides the issue of administration practices, with a special focus on collection and disbursement management practiced by *zakāt* institutions in Malaysia. This chapter and the previous one represent the essential foundation of this study.

Subsequently, chapter four describes the research methods used for data collection, sample selection, procedures and their justifications. It includes research design and explains the development of the questionnaire and interview questions.

In the last chapter, the resulting data is discussed. In this chapter the researcher analyzes data collected through questionnaire, and provides interpretations of the findings of the study. Descriptive statistics were used.

Finally, the study is concluded in chapter six. This chapter summarizes the findings according to the parts of the research questions. It also addresses the contribution of the study. Then it explains the limitations and areas of future research.