

RISK MANAGEMENT FRAMEWORK FOR ZAKAT INSTITUTION

Nazifah Mustaffha^{1*}
Sharifah Norzehan Syed Yusuf²
Nawal Kasim³

¹ Kolej Universiti Islam Antarabangsa Selangor (KUIS)

² Accounting Research Institute (ARI)/Faculty of Accountancy, Universiti Teknologi MARA (UiTM)

³ Faculty of Accountancy, Universiti Teknologi MARA (UiTM)

*Corresponding author (nazifah@kuis.edu.my)

Diterima: 25 August 2019, Diproses: 14 October 2019, Diterbitkan: 1 March 2020

Abstract: Risk management is recognized as a crucial aspect of good governance. The implementation of risk management helps institution to improve their management, use resources effectively and efficiently and provide better services to the stakeholders. Risk management is still new among zakat institutions. Thus, a framework for effective management of risks is needed as guideline for such institutions, especially to those who have implemented corporate governance principles. This is because, risk management is one of the essential elements under corporate governance that need to be focused on. Review of literature indicates that Enterprise Risk Management (ERM) framework is the best practice and it can be applied in the governance of zakat institution. Based on the risk management framework of MS ISO 31000:2010, this paper proposes a risk management framework that is tailored to suit the unique mission, risk contexts and risk profiles of zakat institutions. Generally, this article serves as general guideline for the zakat institutions to implement risk management for the sake of the institution in achieving the noble objective of zakat.

Keywords: Risk Management, Risk Management Framework, Good Governance, Zakat Institution.

INTRODUCTION

Increased concerns regarding corporate accountability in various types of organisations have been associated with the need for appropriate risk management systems. This is due to current and complex challenges and various risks faced by the organizations due to the global exposure and complex operations. These phenomena require them to have effective management and governance to achieve the organizational goals and objectives. Zakat institutions are not excluded from facing such challenges. They are exposed to the same phenomena, consistence with their expansion towards corporatization and growth in their operations in terms of collection and disbursement functions.

Zakat institutions are trusted bodies that manages zakat funds. They have been identified as one of the public institutions that need to be managed, organized and administered effectively and efficiently. This is paramount important due to its vital role in ensuring sustainability of Muslim economic system and the fulfilment of shariah requirements. It is also an integral part that provides the highest level of development for beneficiaries' (*asnaf*)

life. With emergences of advanced technologies worldwide, managing zakat funds in the zakat institutions face various kinds of challenges due to environmental and socio-economic changes in modern societies. In addition, some of the zakat institutions themselves have moved towards corporatization by adopting certain corporate strategies into their governance whenever they suit the nature of the zakat institutions.

The recent performance of the zakat institutions, particularly in Malaysia reflect the complex functions and challenges of these institutions in managing the public and religious funds in order to achieve the noble objectives of zakat in Islam. This indicates the higher risks exposures that these institutions are facing currently. Thus, it is very crucial for the institutions to have proper and effective risk management procedures, which help them achieving better performance in the future and convince the public on their ability to manage zakat funds effectively and efficiently. Thus, this paper proposes general framework as guideline for zakat institutions to practice risk management in their institutions based on literature review and risk management framework of MS ISO 31000:2010.

LITERATURE REVIEW

Zakat Management

Zakat management and administration in Malaysia falls under the jurisdiction of states, i.e. under the State Islamic Religious Council (SIRC) except in the Federal Territories where it is governed by the Federal Government (Wahab & Abdul Rahman, 2011; Salleh, 2014). The law of zakat in the states is provided under their Islamic Law Enactments respectively. Since the Enactments differ from one state to another, the rules governing the zakat matters, including the organizational structure, zakatable items as well as the punishment for various zakat-related offences are different among the states (Zainal, Bakar & Saad, 2016; Bakar, 1998).

For instance, zakat institutions in Malaysia are categorized into four management models (Makhtar, Ahmad, Mat Zain & Nasohah, 2016). The first model refers to zakat collection and distribution functions under the distinctive zakat institution governance, which is separated from the state's Islamic Religious Enactment. This model is applied by Kedah and Sarawak. Lembaga Zakat Negeri Kedah (LZNK) for instance, is established under Enakmen Lembaga Zakat Negeri Kedah Darul Aman 2015, a different enactment from the SIRC's enactment, while Tabung Baitulmal Sarawak was established under Ordinance of Sarawak Islamic Council (Incorporation) (Revised) 1984. The second model reflects the full corporatized zakat institutions, in which zakat collection and distribution functions are managed by a single corporatized zakat institution that established under the Administration of State Islamic Religious Enactment of the respective state Islamic religious council (SIRC). This model is adopted by Lembaga Zakat Selangor (LZS) and Penang Zakat Centre which were established under Trustees (Incorporation) Act 1952 (Revised 1981) and Company Act 1965 respectively.

The third management model refers to the semi-corporatized zakat institutions, where the corporatized zakat institutions under the Administration of State Islamic Religious Enactment of the respective SIRC manage zakat collection, while Baitulmal or Zakat Division of SIRCs manage zakat distribution. This model is adopted by Federal Territory, Malacca, Negeri Sembilan and Pahang. Finally, the fourth model refers to the non-corporatized zakat

institutions that manage both zakat collection and distribution functions directly under the respective SIRC. This model is applied by the SIRC of Johor, Perlis, Perak, Kelantan, Terengganu and Sabah.

Historically, zakat management and administration in Malaysia has evolved from a very traditional way to a modern technique when Majlis Agama Islam Wilayah Persekutuan (MAIWP) Kuala Lumpur or Kuala Lumpur Federal Territory Islamic Council (FTIC) initiated adopting corporate management technique into their zakat collection management. This is called the process of corporatization of the zakat institutions, which is the beginning of the zakat management transformation in this country.

The idea of corporatization is aimed to improve efficiency and effectiveness of the zakat collection system in Kuala Lumpur. Previous studies have shown that the corporatization of several zakat institutions has improved zakat management of the institutions. Specifically, before 1990, all zakat related matters in zakat institutions such as information with regards to zakat payers and recipients as well as collection and disbursement of zakat were managed manually. Beginning 1990s (i.e. post-corporatization), technology such as computerized system has been used especially by the corporatized zakat institutions to replace the manual zakat management gradually (Pusat Pungutan Zakat Wilayah Persekutuan, 2017; Saad, 2000; JAKIM, 2002). This plan has shown its success when the amount of zakat collection keep increasing from year to year (Pusat Pungutan Zakat, 2017). The findings were supported by Mohd Noor, Abdul Rasool, Md Yusof, Ali & Abdul Rahman (2015) who found that fully corporatized zakat institutions perform better than semi-corporatized institutions, which was assessed based on their zakat performance index. This performance at least has shown that there is an increase in the public's confidence towards zakat management by the zakat institutions in Malaysia.

Issues in Zakat Management

Despite the rapid growth of the Malaysian zakat institutions, some people still get suspicious about their governance (Kaslam & Bahrom, 2007; Salleh, 2014; Johari, Fahme & Ali, 2015). Among the issues found include (i) time inefficiency in which waiting period to process the application is too long. The potential recipients need to wait till three weeks to know the results of their application; (ii) dissemination of information regarding the zakat sources and performance is still at low level. Majority recipients got the information from related friends by verbal communication (Johari et al., 2015; Ahmad, Othman, & Salleh, 2015). Additionally, issues on corruption among zakat managers (Berita Harian, July 19, 2017) and zakat collection by unauthorized *amil*s who collect zakat using own-printed receipts (Bernama, June 10, 2018) jeopardize the reputation of zakat institutions in the eyes of potential zakat payers.

In addition, lack of awareness on the importance and compulsory requirement of zakat payment among public, especially among the business owners were also reported through mass media. For example, it was reported that only about 20% of the Muslims' business owner paid business zakat (Foad, 2013 in Abdul Wahab, 2016). This situation seems unresolved when recently it was reported that business zakat awareness in Terengganu (Berita Harian, 12 Jun 2016) and Federal Territory are still low (Berita Harian, 10 April 2018).

These examples are related with reputation risks that lead to collection and distribution risks. In this issue, good rapport of the zakat institutions is very important to promote and inculcate awareness among the potential zakat payers, inclusive of business zakat payers. Thus, zakat institutions should play crucial roles in mitigating those risks as one of the efforts to improve their governance and performance, and subsequently portray good rapport to the public at large.

Risk and Risk Management

Risk is referred to uncertainty and the results of uncertainty (Harrow, 1997) and the possibility of danger, loss, injury or other adverse consequences (Collier, Berry & Burke, 2006). This reflects to a lack of expectedness about a problem structure and/or its consequences in any decision or planning situation. Meanwhile, MS ISO 31000:2010 further defines risk as ‘effect of uncertainty on objectives and it helps decision making process by taking account of uncertainty and its consequences on achieving objectives and assessing the need for any action’ (Department of Standards Malaysia, 2010). The consequences of risks may contribute to opportunities for benefit (positive impact of risks) or threats to success (negative impact) of the organization (IRM, 2002).

As a method to control risks in organization, risk management is a continuous process that is independent on changes in the internal and external environment of the organization. These changes in the environment require continuous attention for identification of risk and risk control (Abu Hussain & Al-Ajmi, 2012). As risks continue to grow and evolve in line with the advancement of technology, risk management capability is also improving towards becoming more complex.

Risk management in particular is defined by IFSB 1 (2005) as a process that consists of risk identification, measurement, mitigation, monitoring, reporting and control. This is in line with MS ISO 31000, in which risk management is referred to coordinated activities to direct and control an organization with regards to risks. These activities which covered under its risk management framework include designing, implementing, monitoring, reviewing and continually improving risk management throughout the organizations (Department of Standards Malaysia, 2010). Simply, the focuses of risk management are identification and treatment of potential risks that harms the performance of the organization. Its objective is to add maximum sustainable value to all the activities of the organization. Thus, it improves achievement, and reduces both the probability of failure and the uncertainty of achieving the organization’s overall objectives (IRM, 2002).

Due to its importance, risk management is recognized as a key activity for all corporations, financial institutions and other types of organizations, including zakat institutions. This is because, risk management is a forward looking approach in managing the possibilities of risks from occurrence. To be detailed, Ismail (2010) defines risk management as the process by which managers satisfy the need to manage institution’s risk exposure by identifying key risk factors; obtaining consistent, understandable, operational risk measures; choosing which risk to reduce, and which to increase and by what means; and establishing procedures to monitor the resulting risk positions. Looking at the definition thoroughly, the implementation of risk management helps institution to improve their management, use

resources effectively and efficiently and provide better services to the stakeholders (Collier et al., 2006).

Thus, risk management plays important role in reducing and eliminating the costs of risk, in making the most effective and efficient use of taxpayer's money (or zakat payers' money in the case of zakat institutions) and in protecting the well-being of communities. Since it finally affects not only the institution, failure to implement an effective risk management program will finally jeopardize a community at large (Qiao, 2007). Accordingly, having risk management in practice is good for an institution.

Risk Management and Zakat Institution

Few studies had been conducted on risk management of zakat institutions (Ascarya, Rahmawati & Beik, 2016; Dyarini & Jamilah, 2017; Rahmatika & Hariono, 2018). Specifically, Ascarya et al. (2016) conducted questionnaire survey, which was modified from the COSO's Enterprise Risk Management (ERM) Integrated Framework (2004) to the respondents from five zakat institutions in Indonesia. In the study, they found that strategic, education, *amil* and volunteer, law as well as compliance risks were among the extreme and high risks in the selected zakat institutions.

In the later year, Dyarini (2017) focus their research on operational risks in zakat institution in Indonesia. Based on the Zakat Core Principles, they have conducted questionnaire and interview surveys in which they evidenced that those institutions are facing with various risks in their operations. For instance, the risks potentially occur in the collection (e.g.: bad reputation and lack of education on the obligation of paying zakat that result in low collection), distribution (e.g.: late distribution and zakat misallocation to non-*asnaf*) as well as fund management operation (e.g.: incompetent and insufficient staff and inefficiency in managing zakat funds). These findings are in consistent with the study of Ascarya et al. (2016).

As per Malaysia, a number of challenges faced by the zakat institution in their efforts to implement risk management. Due to its infancy of implementation, the main challenge faced by zakat institutions is lack of understanding and awareness with regards to the risk management and its importance among the zakat managers (Ali, Mohamad Nor, Shafie, & Wan Ahmad, 2019). This will lead to the low acceptance of risk management in their institution. Furthermore, zakat institutions have lack of or no internal risk management experts. Thus, few zakat institutions have seek for external experts to help them realizing the efforts to implement risk management (Ali et al., 2019).

Regardless of the challenges, few efforts have been initiated by several zakat institutions to implement risk management in their institutions. For example, Malaysia, which was represented by Lembaga Zakat Selangor and Pusat Pungutan Zakat have involved in the efforts to develop (i) International Standard of Zakat Management (ISZM) 2017 (World Zakat Forum, 2017) and (ii) Zakat Core Principles (ZCP) (Beik, Nursechafia, Muljawan, Yusmanita, Fiona & Nazar, 2014). These two working committees are based in Indonesia. Both the ISZM 2017 and ZCP covers the standard requirements and guidelines covering the aspect of risk management, which are applicable to be adapted by the Malaysian zakat institutions.

Looking at the extensive efforts initiated by several zakat institutions in practicing risk management, it is great to have risk management framework as general guideline for other zakat institutions to have such practice in their institutions.

PROPOSED RISK MANAGEMENT FRAMEWORK FOR ZAKAT INSTITUTIONS

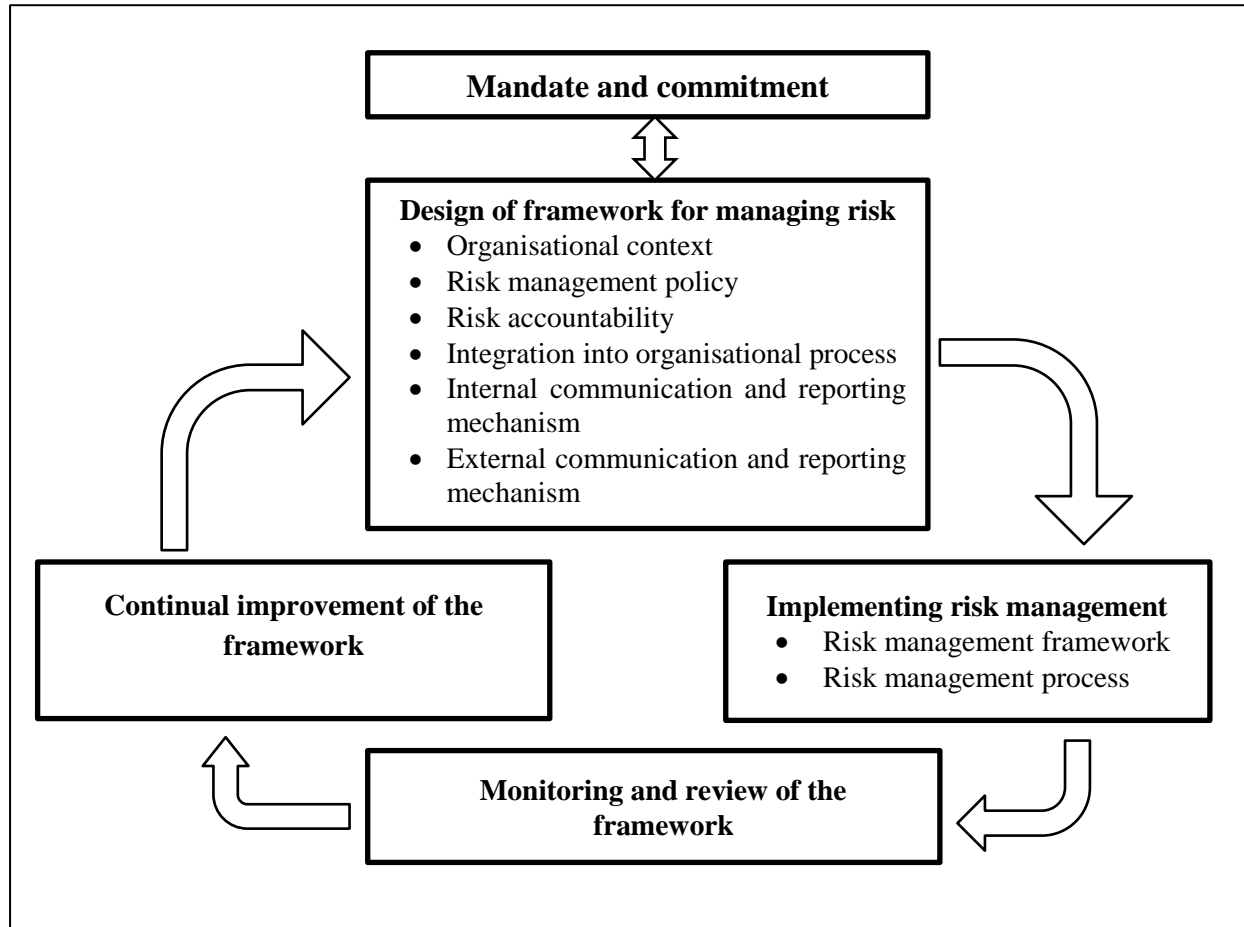


Figure 1: Proposed Components of Risk Management Framework (Based on MS ISO 31000)

Generally, risk management is a crucial element that needs to be efficiently implemented by any organization to achieve their mission and vision. Zakat institutions are not in the exemption of this. Risk management is paramount important since zakat institutions control significant financial resources. Thus, risk management is important to improve their performance and subsequently enable zakat to be a catalyst in improving the lives of the poor and needy (Mahyuddin & Abdullah, 2011). Figure 1 illustrates the proposed components of risk management framework for the institution, based on the MS ISO 31000:2010. The standard is used as the basis for the adaption of the framework because the standard is based on the ISO 31000, which is the latest, internationally recognized, industry-neutral and most

intuitive standard. It contains a clear process description and harmonized language (Abu Bakar, 2014) making it a good base for zakat institutions' specific framework.

Basically, the framework is not intended to prescribe a management system, but rather to assist the institution to integrate risk management into its overall management system. Therefore, institutions should adapt the components of the framework to their specific needs. If an institution's existing management practices and processes include components of risk management or if the institution has already adopted a formal risk management process for particular types of risk or situations, then these should be critically reviewed and assessed against the Risk Management Standard in order to determine their adequacy and effectiveness (MS ISO 31000).

Major goal of the adaptation of MS ISO 31000 will naturally be to help zakat institutions to lessen risks in their daily operation and management. Thus, such an adaptation covers operational areas and key strategic management areas. This adaptation also encloses the internal and external elements of the institution, regarding its organizational set-up or its surrounding environment, in order to capture potential risks that may arise in these areas. This stresses the holistic approach that is intended to be given to this proposal.

Hence, this proposed framework is hoped to help zakat institutions to introduce risk management practices in identifying, assessing and managing the existing and potential risks without focusing on one specific area only. Additionally, it does not only help the institution to focus on internal and external risks in their environment, but also involve their stakeholders in the risk management process (Abu Bakar, 2014). This can only be achieved if the proposed framework is easily understandable, yet still customizable by each zakat institution and adjustable to the nature, needs and requirements of each institution.

First and foremost, mandate and commitment requires the management team of zakat institution to plan and implement strategically the risk management framework to ensure the risk management ongoing effectiveness. The mandate includes defining and endorsing the risk management policy, ensuring the synchronization of institutional culture and risk management policy, aligning the risk management policy with the institution's goals and objectives as well as ensuring legal and regulatory compliance (Department of Standards Malaysia, 2010).

One of the most important mandate of the management is to design the risk management framework for their zakat institution. This mandate requires the management to design the framework that tailors to their institutional context, including the involved resources, risk management policies and risk management accountabilities. Then, they need to plan how to integrate the risk management policies within the institutional operation and process. Additionally, the risk management activities need to be communicated and reported internally within the institution and externally to the public to increase and establish their accountability and transparency to the stakeholders.

As for the implementation phase, the institution should implement the developed framework effectively and efficiently. Thus, they need to define the appropriate timing and strategy to apply the risk management policy and implement the risk management process while complying with legal and regulatory requirements. The risk management process includes risk identification, risk analysis, risk evaluation and risk treatment. This process

should be applied through a risk management plan at all relevant levels, departments and functions of the institution (Department of Standards Malaysia, 2010).

The risk management framework should be monitored and reviewed periodically to ensure its effectiveness and relevancy in supporting the institutional performance. In this phase, the institution should measure risk management performance against indicators, which are periodically reviewed for appropriateness and in line with the risk management plan. In case of inefficiency, the existing risk management framework need to be revised and amended accordingly for continual improvement of the framework.

CONCLUSION

Generally, zakat institutions in Malaysia have experienced tremendous growth in terms of collection and distribution. However, despite the growth in collection and distribution of zakat, zakat institutions are exposed to various types of risks that may affect their performance and subsequently influence the confidence level of the public to pay zakat to the formal zakat institution.

Since every institution must face risks, they are responsible to cater and manage the risks wisely and effectively. However, due to the absence of proper risk management guidelines, the way they manage risks might be different from one state to another. And the worse thing is that, the implementation of risk management does not help in improving the performance of the institutions. Due to this scenario, the present paper proposes a basic framework of risk management for zakat institution, that can be tailored to the nature of individual zakat institution since every institution may differ in terms of governance practice.

Future research should be undertaken to evaluate how zakat institutions manage their risks with or without proper risk management procedures, depending on the availability of the procedures within the institution.

REFERENCES

- Abdul Rahman, Z. (1996). Corporatisation – the Malaysian experience. In Syed Abdus Samad & McMaster, J. (eds.), *Corporatisation in Asia and the Pacific: Profiles, strategies, results*. Kuala Lumpur: Asian and Pacific Development Centre.
- Abdul Wahab, A. (2018). Faktor yang Mempengaruhi Pembayaran Zakat di Syarikat Tersenarai Awam di Malaysia. Unpublished thesis, Universiti Malaya.
- Abu Bakar, N. A. (2014). PRINCIPLES AND GUIDELINES International Standards for the Management of Risk. In SEMINAR ON MS ISO 31000: 2010 RISK MANAGEMENT.
- Abu Hussain, H. & Al- Ajmi, J. (2012) "Risk management practices of conventional and Islamic banks in Bahrain", *The Journal of Risk Finance*, Vol. 13 Issue: 3, pp.215-239.
- Ahmad, R. A. R., Othman, A. M. A., & Salleh, M. S. (2015). Assessing the Satisfaction Level of Zakat Recipients Towards Zakat Management. *Procedia Economics and Finance*, 31(15), 140–151. [https://doi.org/10.1016/S2212-5671\(15\)01141-7](https://doi.org/10.1016/S2212-5671(15)01141-7).
- Ali, A., Mohamad Nor, M. N., Shafie, R., & Wan Ahmad, W. N. (2019). Implementation of Good Risk Management Practices For Zakat Institution. *International Journal of Zakat and Islamic Philanthropy*, 1(1), 45–52.
- Ascarya, Rahmawati, S. & Beik, I. S. (2016). *Merancang Manajemen Risiko Pengelolaan Zakat* (Developing Risk Management for Zakah Institution). Paper presented on 30 November 2016.
- Beik, I. S., Nursechafia, Muljawan, D., Yumanita, D., Fiona, A. & Nazar, J. K. (2014). Towards an Establishment of an Efficient and Sound Zakat System. Working paper presented in the Working Group of Zakat Core Principles 2014.
- Berita Harian (July, 19, 2017). <https://www.bharian.com.my/berita/kes/2017/07/303661/ceo-pegawai-zakat-pulau-pinang-didakwa-rasuah>.
- Bernamea (June 10, 2018). <http://www.astroawani.com/berita-malaysia/hati-hati-kutipan-zakat-fitrah-tidak-bertauliah-di-kedah-lznk-177803>
- Collier, P. M., Bery, A. J. & Burke, G. T. (2006). Risk and management accounting: best practice guidelines for enterprise-wide internal control procedures. Research Executive Summaries Series, Vol. 2, No. 11. London: CIMA Publishing.

- Department of Standards Malaysia (2010). MS ISO 31000:2010 Risk Management – Principle and Guideline. Selangor, Malaysia.
- Dyarini & Jamilah (2017). Manajemen Risiko Pengelolaan Zakat. *Ikraith-Humniora*, 1(2): 45 - 52.
- Harrow, J. (1997). Managing risk and delivering quality services : a case study perspective, 10(5), 331–352.
- Ibrahim, M. A. (2017). Keperluan Kerangka Syariah dalam Tadbir Urus Zakat (The Needs of Shariah Framework in Zakat Governance). In *Memperkasa Kutipan dan Agihan Zakat Di Malaysia (Empowering Zakat Collection and Distribution in Malaysia)*. Edited by: Musa, Z. M., Ab. Rahman, A. & Abdul Wahab, A. (2017). Negeri Sembilan: Penerbit USIM.
- Institute of Risk Management (IRM) (2002). A Risk Management Standard. London.
- Ismail, A. G. (2010). Money, Islamic Banks and the Real Economy. Singapore: Cengage Learning Asia Pte. Ltd., pp. 242.
- Jabatan Kemajuan Islam Malaysia [JAKIM]. (2002, October). Laporan kajian pelaksanaan agihan zakat kepada asnaf fakir dan miskin di Malaysia [Report on the practice of zakat disbursement to the poor and needy category in Malaysia]. Paper presented at Muzakarah Pelaksanaan Agihan Zakat kepada Fakir & Miskin di Malaysia, Langkawi.
- Johari, F., Fahme, A., & Ali, M. (2015). A Review of Literatures on Current Zakat Issues : An Analysis between 2003 - 2013, (2), 336–363.
- Kaplan, R. S. (2012). Risk Management. Kaplan Financial Knowledge Bank (KFKB). kfknowledgebank.kaplan.co.uk/KFKB/Wiki%20Pages/Risk%20management.aspx. Assessed on 12 December 2017.
- Kaslam, S. & Bahrom, H. (2007). “Amalan ‘Corporate Governance’ dalam Pengurusan Institusi Zakat di Malaysia”. *Jurnal Pengurusan Jawhar*, 1(2): 53-70.
- Lembaga Zakat Selangor (2016). Laporan Pengurusan Zakat Selangor 2016.
- Mahyuddin, A. B. & Abdullah A.G. (2011). Towards Achieving the Quality of life in the Management of Zakat Distribution to the Rightful Recipients (the Poor and Needy). *International Journal of Business and Social Science*, 2(4), 237-245.
- Makhtar. A. S., Ahmad, S., Mat Zain, M. N. & Nasohah, Z. (2016). *Transformasi Pengurusan Zakat dan Model Pelaksanaannya di Malaysia* [Zakat Management Transformation and Application Models]. Paper presented at Persidangan Antarabangsa Perundangan Islam, Krabi, Thailand.
- Mohd Noor, A. H., Abdul Rasool, M. S., Md Yusof, R., Ali, S. M. & Abdul Rahman, R. (2015). Efficiency of Islamic Institutions: Empirical Evidence of Zakat Organizations’ Performance in Malaysia. *Journal of Economics, Business and Management*, 3 (2): 282-286.
- Pusat Pungutan Zakat (2017). Ringkasan Laporan Zakat PPZ 2017.
- Qiao, Y. (2007). Public Risk Management: Development and Financing. *Journal of Public Budgeting, Accounting & Financial Management*, 19(1), 33–55.
- Rahmatika, A. N. & Hariono, T. (2018). Risk Management of Zakat Maal Supervision in the Fintech Era based on Literature Review. *Proceeding of International Conference of Zakat 2018*, p. 195 – 201.
- Saad, I. (2000, February). Cara pengagihan dana zakat Majlis Agama Islam Negeri Pulau Pinang [Methods of disbursing zakat funds by Penang SIRC]. Paper presented at Seminar Kebangsaan Kaedah Pengagihan Dana Zakat : Satu Perspektif Islam, Kuala Lumpur.
- Wahab, N. A., Rahim, A., & Rahman, A. (2011). A Framework to Analyse the Efficiency and Governance Of Zakat Institutions, *Journal of Islamic Accounting and Business Research*, 2(1), 43–62.

- World Zakat Forum - WZF (2017). *International Standard of Zakat Management: ISZM 2017*. Ciputat, Indonesia: IMZ Publishing.
- Zainal, H., Bakar, A. A., Al, R., Saad, J. (2016). Satisfaction of Zakat Distribution, and Service Quality as Determinant of Stakeholder Trust in Zakat Institutions. *International Journal of Economics and Financial Issues International Journal of Economics and Financial Issues, International Soft Science Conference*, 6(S7), 72–76.