

A STUDY OF DISCLOSURE PRACTICES AND
ACCOUNTABILITY OF MALAYSIAN
ZAKAT INSTITUTIONS

BY

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ABSTRACT

The current study aims to investigate the accountability on the disclosure of zakat institutions (ZIs) through their annual reports. This study is motivated by the findings from previous studies regarding inadequate information disclosure by ZIs especially information on zakat disbursement as had been raised by the zakat payers (ZPs) and zakat recipients (ZRs). This has sparked public debates regarding the accountability and transparency of ZIs in disclosing zakat information, especially for public viewing. The issue further rose as there is an asymmetrical of information exists among the agency parties representing the ZIs i.e. the zakat managers (ZMs), ZPs, and ZRs as discussed in the past literature. As ZIs fall under the jurisdiction of the states, the current study believes that the issue emerged due to the inconsistencies of disclosure practices among the institutions. In light of this gap and limited studies regarding this area; the study intends to explore deeper disclosure practices in ZIs' annual reports by asking the opinions of agency parties and to propose a zakat disclosure index known as *i-ZkDI*. Additionally, the current study is also interested in identifying the expectations from panel of experts with respect to the adequacy of disclosure by ZIs. A sequential exploratory mixed-method approach and content analysis of ZIs' annual reports were employed. Findings from the interviews conform the existence of asymmetrical information among the agency parties. On the contrary, the ZMs opined that the reports prepared are sufficient although they acknowledged it needed improvements. In the second phase, through the Delphi technique, a total of 96 disclosure items with five categories were agreed and confirmed by the panel of experts. The financial information category emerged as the top-rated category with the highest mean score accorded by the panel members. In the final phase, the content analysis showed that the extent of the ZIs' disclosure is still insufficient. Therefore, it is evidenced that the ZIs' disclosure of zakat information via annual reports are still inadequate, hence suggesting the impairment of accountability. This study contributes to the body of knowledge on the accountability of religious institutions, specifically on ZIs' disclosure with annual reports. Further, it also enriched the knowledge on Accountability from an Islamic perspective and Agency theory in the context of zakat disclosure, in general. The study recommends the authority to establish a central body to govern the zakat affairs in the country, and form a standardised or common reporting practices among the states. It is hoped with these taken into consideration, it would entail better disclosure practices of zakat institutions in Malaysia.

خلاصة البحث

تهدف هذه الدراسة إلى تقييم مسؤولية مؤسسات الزكاة في الإفصاح عن أنشطتها من خلال الكشف عنها في التقارير السنوية . تحفز هذه الدراسة نتائج الدراسات السابقة بشأن عدم كفاية المعلومات من قبل مؤسسات الزكاة خاصة بشأن معلومات صرف الزكاة كما أثارها دافعوها و مستلميها. أثار هذا الموقف نقاشات عامة حول مسؤولية وشفافية مؤسسات الزكاة في الكشف عن معلومات الزكاة ، وخاصة للعرض العام . تصاعد الموضوع بوجود معلومات غير متماثلة بين أطراف الوكالة التي تتمثل مؤسسات الزكاة ، أي المدراء و الدافعين و المستلمين كما نوقشت في الدراسات السابقة . ونظرًا لأن مؤسسات الزكاة تندرج ضمن اختصاص الولايات ، تعتقد الدراسة الحاليه أن المشكلة نشأت بسبب تضارب ممارسات الإفصاح بين المؤسسات . وإدراكًا لهذه الثغرة والدراسات المحدودة هذا المجال ، تعتمزم الدراسة استكشاف ممارسات الإفصاح الأعمق في التقارير السنوية لمؤسسات الزكاة عن طريق سؤال آراء أطراف الوكالة واقتراح لدراسة مدى كشف تقارير أنشطتها . بالإضافة، الدراسة مهتمه **ZkDI-i** مؤشر الكشف عن الزكاة المعروف باسم بالتحقق إذا كانت توقعات لجنة من الخبراء مماثلة بالنسبة إلى الإفصاح من جهة مؤسسات الزكاة. تم تطبيق نهج استكشاف تسلسلي محتلط الطريقه وتحليل محتوى التقارير السنوية لمؤسسات الزكاة. وتؤكد نتائج المقابلات وجود معلومات غير متكافئة بين أطراف الوكالة. و على العكس ، رأي مدراء الزكاة أن التقارير التي تم إعدادها كافية على الرغم من اعترفهم أنها بحاجة إلى تحسينات. في المرحلة الثانية ، من خلال تقنية دلفي ، تم تأكيد ما مجموعه 96 عنصر إفصاح مع خمس فئات من قبل فريق الخبراء. برزت فئة المعلومات المالية باعتبارها الفئة الأعلى تصنيفًا بأعلى متوسط درجة منحه أعضاء الفريق. و في المرحلة الأخيرة ، أظهر تحليل المحتوى أن مدى إفشاء مؤسسات الزكاة لا يزال غير كاف. لذلك ، من الواضح أن إفصاح مؤسسات الزكاة للمعلومات عن طريق التقارير السنوية لا تزال غير كافية ، مما يشير إلى ضعف المسؤولية. تسهم هذه الدراسة في مجموعة المعرفة حول مسؤولية المؤسسات الدينية ، وتحصوصاً حول إفصاح مؤسسات الزكاة للتقارير السنوية. وكذلك ، إثراء المعرفة بشأن المسؤولية من منظور إسلامي ونظرية الوكالة في سياق الإفصاح عن الزكاة بشكل عام. توصي الدراسة السلطة لإنشاء هيئة مركزية تحكم شؤون الزكاة في البلد ، وتكوين ممارسات إبلاغ موحدة أو مشتركة بين الولايات. ومن المأمول أن تؤخذ التوصيات في الاعتبار أفضل ممارسات الإفصاح لمؤسسات الزكاة في ماليزيا.

APPROVAL PAGE

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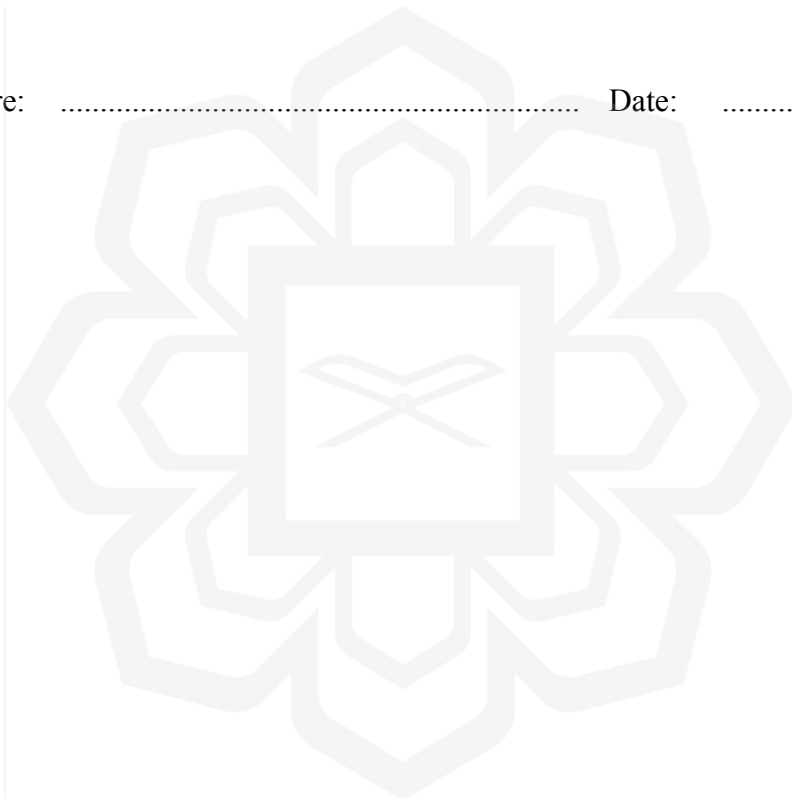
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DECLARATION

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LIST OF ABBREVIATIONS

AGD	Accountant General Department
AI	Accountability Index
AT	Agency Theory
BI	background information
CZPs	Corporate zakat payers
FI	Financial Information
FRDI	Financial Reporting Disclosure Index
FRS	Financial Reporting Standards
FT	Future Information
GI	Governance Information
<i>i</i> -ZkDI	Zakat Disclosure Index
IPSAS	International Public Sector Accounting Standards
IZPs	Individual zakat payers
JAWHAR	Department of Awqaf, Zakat and Hajj/Jabatan Wakaf, Zakat dan Haji
LZS	Lembaga Zakat Selangor
MACC	Malaysian Anti-Corruption Commission
MASB	Malaysian Accounting Standards Board
MPERS	Malaysian Private Entity Reporting Standards
NAD	National Audit Department
NDB	Non-Disbursement Balance
NFI&P	Non-Financial information & Performance
NGOs	Non-Government Organisations
NPOs	Non Profit organisations
PERS	Private Entity Reporting Standards
PPZ	Pusat Pungutan Zakat
RNPOs	Religious Non Profit Organisations
SAD	State Audit Department
SIRC <i>s</i>	State Islamic Religious Council
SORPs	Statement of Recommended Practice
ZIs	Zakat Institutions
ZMs	Zakat Managers
ZPs	Zakat Payers
ZRDI	Zakat Reporting Practices Disclosure Index

CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION

These days, a call for greater accountability is regularly spelt out not only for the private sector but also for government agencies and non-profit organisations. Across the globe, the issue of accountability has become a public discussion as well as attracted many debates and arguments in academic literature. Currently, the issue takes prominence especially concerning the government and non-profit organisations as their primary objective is not related to profit motives.

Within the context of government agencies in Malaysia, one specific part of State Islamic Religious Councils (SIRCs), i.e., Zakat Institutions (ZIs), have been receiving substantial attention and facing pressure from the public especially the Muslim community. As one of the faith-based religious institutions, ZIs are responsible for handling millions of public money collected from the Zakat Payers (ZPs), which later to be disbursed to qualified¹ Zakat Recipients² (ZRs). The Muslim community nowadays demands transparent zakat information on how the money is spent, as many reports produced by local media have criticised ZIs in terms of accountability in managing the institutions, for example, embezzlement of public funds and misconducts, as claimed by Rosnia, Khaled, and Doaa (2018), Noorlaila, Roshayani, and Norzaihan (2013), Suraya (2011, August 7), Utusan Malaysia (2011,

¹ Those who receive zakat according to the individual state *fatwa* council.

² Used interchangeably with the term *asnaf*.

December 29), Hadzlihady (2017, May 9), and Audrey (2017, May 16). The accountability and transparency of ZIs in reporting their activities are questioned further following a wide media coverage on issues such as misuse of zakat funds by zakat employees, incidences of poverty, and failure of ZIs in preparing financial statements (Abd Halim, Mohamed Saladin, Rozman, Siti Mariam, & Rashidah, 2015; Ram Al Jaffri, 2011). Moreover, Hairunnizam, Sanep, and Radiah (2010) revealed that one of the reasons that ZPs prefer to pay their zakat directly to the beneficiaries is due to the lack of information provided by ZIs, especially on zakat disbursement. It indirectly portrays inadequate dissemination of information to the public and the existence of an information gap among the users. From one perspective, the study notices that these criticisms are useful in the context of improving the ZIs' performance, but at the same time, it may eventually undermine public confidence and create a negative perception towards the ZIs.

In response to these concerns, essential efforts have been made by responsible authorities such as the National Audit Department³ (NAD) towards improving the reporting practices, accountability, and transparency through higher disclosure by public sector agencies. One of the initiatives is creating a ranking system using the Accountability Index (AI) in 2007 to standardise the scoring system across the entire government agencies (www.audit.gov.my/). The issue has also caught the attention and concern of the Accountant General Department (AGD). It is important to acknowledge that apart from NAD and AGD, the Malaysian Accounting Standards Board (MASB) also plays a vital role in consideration of the preparation of the

³ Malaysian Supreme Audit Institution is responsible for evaluating the management performance of all ministries, departments, and autonomous entities at the central, state, and local governments in Malaysia.

financial statements of SIRC's as well as the ZIs. This is because the MASB has issued Malaysian Private Entities Reporting Standards (MPERS) that applies to private entities in Malaysia and came into force on 1st of January 2016 replacing Private Entities Reporting Standards (PERS) that was used previously⁴. As ZIs are under the purview of SIRC's, the issuance of the AI and MPERS would probably affect the reporting and disclosure of SIRC's especially the ZIs.

In ensuring the accountability of ZIs in reporting their activities, the content of annual reports is essential to be observed (Rosnia et al., 2018). Hence, the study intends to assess the accountability of ZIs in reporting their activities by investigating their current disclosure practices, proposing a disclosure index for Malaysian ZIs, and examining the extent that they discharge their accountability via the annual reports. This is achieved by exploring the opinions of agency parties (zakat managers⁵ (ZMs), ZPs, and ZRs) with respect to ZIs' disclosure practices, identifying the expectations on information necessary for disclosure, and eventually determining whether the disclosure expectations as proposed and agreed by the agency parties (represented by the Delphi experts) are met in discharging ZIs' accountability via the annual reports.

Previously, many literature works on zakat in Malaysia highlighted various issues pertaining to zakat administration such as zakat collection, disbursement aspect, governance and human resources mechanisms. However, few empirical works have been found in discussing the aspect of reporting accountability specifically in disclosure practices. Nevertheless, the study notices that Muslim scholars have initiated efforts in this area. Many studies are still lacking in terms of providing

⁴ Some of the ZIs adopted PERS in preparing the financial statements.

⁵ Representing zakat officers, accountants, internal auditors, and zakat executives.

comprehensive discussions on this issue. Unlike the rest, this study explored, adopted mixed method approach, dealt with matters concerning zakat parties/experts by inviting them as participants, and considers the structures of ZIs (details in Chapter Two). The study believes it is essential to explore these aspects in order to provide a better understanding of the ZI disclosure field. Thus, the current study provides empirical evidence on how accountability in the context of ZIs' disclosure practices is operationalised. Most importantly, it contributes to the knowledge of ZIs' accountability disclosure practices by considering the agency parties' opinions and the structures of ZIs.

This chapter commences by providing the background of the study. It begins with an overview of zakat, highlighting its importance as one of the religious obligations, as well as providing its definitions and objectives, supported by verses from the *Qur'an* and hadith⁶. Then, it continues by describing ZIs in the Malaysian context covering their history and structures. Next, the problem statement that consequently leads to the research questions and objectives of the study is discussed. Finally, the significance of the study is highlighted and the overall structure of the study is explained.

1.2 BACKGROUND OF ZAKAT

Zakat is one of the five pillars of the Islamic faith that aims to secure the socio-economic welfare of the poor and needy. Sabahaddin (1989, p.101) described zakat as a compulsory payment that is levied on members of the Muslim community to transfer

⁶ The practices and sayings of Prophet Muhammad (s.a.w).

the surplus wealth and earning from the comparatively well-to-do-members to the destitute and the needy. The term Muslim is further described as a person, including individuals and businesses, where every wealth created and every income received is subjected to zakat. It does not specifically refer to only individuals, but also includes business wealth inclusive of sole proprietorships, partnerships, and corporations that fulfil zakat conditions. From the economic lens, every Muslim, whose specified wealth meets certain conditions as prescribed by the Islamic *Syariah* is obliged to spend part of their wealth to the people who are eligible to receive zakat, i.e., *asnaf*⁷ (Abdul Rahim, 2005). This mandatory obligation is evidenced in the *Qur'an* and hadith as the following:

“O ye who believe! Give of the good things which ye have (honorably) earned, and of the fruits of the earth which We have produced for you, and do not even aim at getting anything which is bad, in order that out of it ye may give away something, when ye yourselves would not receive it except with closed eyes. And know that Allāh is Free of all wants, and worthy of all praise.”(Al-Baqarah: 267)

“And be steadfast in prayer, practise regular charity, and bow down your heads with those who bow down in worship.” (Al-Baqarah: 43)

“Whereas Prophet (s.a.w) urged us to pay zakat on products that we offer for sale.” (Narrated by Abu Daud)

Muhammad (1980) as cited by Abdul Rahim (2007) provided a more detailed description of zakat. The term *zakat* can be best explained in three different connotations: linguistic, theological, and legal aspects. The former perspective describes zakat as a process of purification and sanctification of the heart from dirt. It also refers to praise, growth, and increase. The theological aspect portrays that the implication or consequence of practising zakat is spiritual purification, while from the

⁷ Zakat recipients/beneficiaries

legal aspect, zakat signifies the transfer of ownership of an individual or individuals' specific wealth under certain fulfilled conditions. In other words, fulfilling such an obligation not only purifies one's wealth but also creates a more balanced socio-economic wealth, thus reduces the gap between the rich and the poor, allowing them to live in harmony and most importantly achieve *mardhiyatullah* (blessings of Allāh). In essence, this has been reminded by our Prophet Muhammad (s.a.w)⁸ in his last memorable speech. The sermon was delivered on the Ninth Day of *Dhul-Hijjah*⁹ 10 A.H. in Mecca¹⁰. Below are the related Qur'anic verse and the speech of the Prophet (s.a.w), respectively:

“Behold! Worship your Lord; offer prayers five times a day; observe fast in the month of Ramadhaan; pay readily the Zakat (poor due) on your property; and perform pilgrimage to the House of God and obey your rulers and you will be admitted to the Paradise of your Lord.”

This fundamental obligation of Muslim plays a vital role in the Islamic economy as well as being one of the essential economic tools to relieve poverty among members of the *ummah*¹¹. Therefore, zakat is able to reduce the inequality and unfairness of income distribution, expand the circulation of wealth in society, reduce the gap between poor and rich people, provide social security, and minimise unemployment, with the end result of achieving economic stability and economic development of the *ummah* in the long-run (Norma & Naziruddin, 2013; Mohammed & Sorfina, 2012; Patmawati, 2009). Moreover, zakat grants a balanced economic

⁸ Islamic expression used whenever the name of Prophet Muhammad is mentioned.

⁹ A month in the Islamic calendar.

¹⁰ The holiest city of Islam, located in Saudi Arabia.

¹¹ Muslim community.