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# Synergizing Normative and Cultural Frameworks in Reforming Core Principles for Effective Zakat Supervision

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**Abstract:** In recent years, an international initiative led by IRTI and other prominent scholars, has developed guidelines known as the Zakat Core Principles for effective zakat supervision. However, while these efforts represent significant progress and are widely adopted in the Islamic world, we argue that it misses a key piece of the normative and cultural frameworks by not examining how Muslim public support could influence the effectiveness of alternative supervision methods. In environments where transparency and disclosure are prioritized, these cultural norms play a crucial role in differentiating between legitimate and illegitimate zakat transactions. However, the international working group on zakat core principles, which primarily emphasizes financial reporting and institutional development, often overlooks these cultural and moral dimensions essential for effective supervision. This paper draws insights from international practices, such as the Islamic Bank of Thailand's zakat account, where funds are managed within Islamic financial institutions under stringent supervision, and the Lembaga Zakat Negeri Kedah's approach to risk management and public accountability. It argues for adopting an integrated approach that incorporates normative and cultural dimensions, aligned with Indonesia's religious and social contexts, for a more comprehensive zakat supervision and fund management strategy. This approach will not only improve the efficiency of zakat distribution but also enhance public trust in zakat institutions, leading to increased zakat collection and a greater positive impact on those in need.

**Keywords:** Zakat Management; Islamic Finance; Transparency; Supervision; Public Trust

## I. INTRODUCTION

In the field of Islamic economics, the material aspect is not positioned as the primary goal of economic activity. Islam perceives economic activity as a noble undertaking, presenting motives and orientations that encompass fairness and the welfare of society in all forms of economic endeavours.<sup>1</sup> Hence, the objective and achievement of economic pursuits in Islam revolve around attaining *falah*. *Falah*, stemming from the root word *Afalaha-Yuflihu*, connotes success, nobility, and triumph. Therefore, the multidimensional nobility inherent in engaging

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<sup>1</sup> Romi Adetio Setiawan, 'Impact of Islamic Jurisprudential on Traditional Financial Customs and Legal Integration in Indonesia' (2023) 13(2) Journal of Islamic Thought Civilization 195, 196.

1 in economic activities within an Islamic framework extends beyond a sole focus on material gains, encompassing spiritual achievements and considerations for the afterlife.<sup>2</sup>

Zakat, a fundamental pillar of Islamic finance, plays a crucial role in this framework. It is deeply embedded in social relationships between *muzakki* (givers) and *mustahik* (recipients), reflecting a system that persists globally due to its social and ethical dimensions.<sup>3</sup> However, there is a notable gap in understanding how these social connections function within frameworks that emphasize disclosure and transparency. This gap primarily concerns the regulation and control of informal, unwritten agreements involved in zakat distribution. In Indonesia, the disbursement of zakat funds is often inadequately regulated and supervised, leading to potential misuse, especially by politically motivated individuals or groups.<sup>4</sup> In developed economies, similar unregulated transactions are frequently classified as criminal due to risks such as money laundering or fraud.<sup>5</sup>

Dikuraisyin and Dayanti delineated three challenges encountered in the allocation of zakat funds: Initially, the complexity revolves around assessing the economic advancement of recipients (*mustahik*).<sup>6</sup> This challenge stems from the prevailing approach to distribution adopted by zakat institutions, which frequently leans towards immediate, charitable disbursements, resulting in an inability to disrupt the cycle of poverty for the beneficiaries. Moreover, these institutions often lack a robust economic strategy, leading to ineffectual endeavours. Secondly, there is a discrepancy between escalating operational expenses and the efficient dissemination of funds. Thirdly, the unstructured process of identifying beneficiaries presents a significant hurdle.<sup>7</sup>

In scholarly literature and among law enforcement officials, theories from law and economics that provide a framework for standardizing zakat fund management, such as those proposed by the International Working Group on Core Principles for Effective Zakat Supervision, are widely recognized and adopted.<sup>8</sup> However, these core principles predominantly focus on financial reporting and institutional development. Conversely, Greif's theory of a multilateral reputation-based mechanism (MRM) addresses the issue of trust in transactions where parties might be tempted to cheat for personal gain.<sup>9</sup> The MRM, which emerged as a response to traders' self-maximizing behaviour, effectively mitigates trust issues in one-off transactions. Nevertheless, this theory does not incorporate the influence of religious law and cultural factors in its regulatory framework, which are crucial for fostering trust and managing fund disbursements in the context of informal agreements.

2 Makhrus Ahmadi, 'Pengembangan Dana Zakat, Infak, Shadaqah Dan Wakaf Terhadap Pertumbuhan Industri Keuangan Non Bank Syariah' (2017) 2(2) *Jurnal Masharif al-Syariah* 1, 13.

3 Samir Alamad, *Financial and Accounting Principles in Islamic Finance* (New York: Springer International Publishing 2019) 28.

4 Romi Adetio Setiawan, 'Issues in Islamic derivatives and proposals for reforms in the OTC Market in Indonesia' (2022) 15(5) *Journal of Risk Financial Management* 222, 222-227.

5 Jonathan G Ercanbrack, 'Hawala in criminal court: the role of law and commercial culture in informal financial exchange' (2024) *Crime, Law and Social Change* 1, 1-5.

6 Basar Dikuraisyin and Erinda Dayanti, 'Pemetaan Ideal Pola Distribusi Dana Zakat dan Wakaf untuk Kesejahteraan Mustahik (Studi di Lembaga Zakat Yatim Mandiri Surabaya, Jawa Timur)' (2021) 1(1) *Zawa: Management of Zakat and Waqf Journal* 15.

7 *ibid.*

8 International Working Group on Zakat Core Principles, *Core Principles for Effective Zakat Supervision* (Jakarta: National Board of Zakat of the Republic of Indonesia and Central Bank of Indonesia 2016) 1-20.

9 Avner Greif, 'Contract Enforceability and Economic Institutions in Early Trade: The Maghribi Traders' Coalition' (1993) 1 *The American Economic Review* 525, 527.

Previous research predominantly interprets zakat management through the lens of neo-institutional economic theories, which posit that self-maximizing behaviour drives the development of institutional adaptations, such as enhancing reputation through improved financial reporting quality. For instance, Wahyudi et al. analyse Indonesia's institutional void and demonstrate how zakat institutions function similarly to informal banking systems by improving the quality of financial reports.<sup>10</sup> Similarly, studies on zakat fund management across three different Muslim countries emphasize the central role of robust reporting systems in enhancing institutional performance.<sup>11</sup>

Levianto examines the failure of zakat management institutions in the context of risk management, highlighting the critical importance of transparency in both financial reporting and operational practices.<sup>12</sup> In a distinct approach, Sri et al. emphasize the role of social embeddedness in their economic analysis of zakat community development, where cultural and social-religious influences create special conditions and limitations that affect the effectiveness of zakat fund management.<sup>13</sup> Although they recognize that the selection and organization of institutions are not solely driven by economic efficiency, their analysis still focuses on the maximization of zakat institutional funds, rather than on supervision and regulation.

Although the financial reporting is significant for the transparency, it alone may not fully address the complexities of zakat supervision. We argue that, in the context of emphasizing disclosure and transparency, the normative and cultural dimensions play a significant role in differentiating between legitimate and illegitimate transactions. Thus, this is considered as a gap in the existing literatures, where there is still limited study on how these social and cultural factors can be leveraged to enhance zakat supervision and improve fund management, suggesting the need for a more holistic approach that integrates both financial and normative frameworks.

This paper is structured as follows. Section One presents the methodology employed in the study. Section Two considers the Islamic financial principles on zakat for economic empowerment. Section Three examines the international zakat core principles. Section Four reviews international case studies related to zakat, addressing associated risks and the normative aspects of zakat fund management. Section Five discusses the findings and analysis concerning the risks and regulatory frameworks governing zakat fund management. Finally, Section Six offers conclusions and recommendations, emphasizing how incorporating normative frameworks and stringent supervision can enhance transparency and restore public trust.

## II. METHODOLOGY

The qualitative descriptive research is employed in this study with the content analysis approach to draw the conclusions by identifying the characteristics of messages within the data. This approach is combined with an Islamic economic perspective and normative aspects from

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<sup>10</sup> Muhammad Wahyudi, Nurul Huda, Sri Heraningrum, Ririn Ratnasari 'Zakat Institution of Financial Transparency Model: An Explanatory Research' (2021) 8(1) ZISWAF: Jurnal Zakat dan Wakaf 122, 130.

<sup>11</sup> An'im Kafabih and Setyo Wahyudi, 'Zakat and Economic Development: Study in Three Muslim Countries in Southeast Asia' (2021) 9(1) Quantitative Economics Journal 1, 1-5.

<sup>12</sup> Jubei Levianto, 'Ketika Komersialisasi Agama dan Penipuan Berjalan Beriringan: Kasus Aksi Cepat Tanggap' (2024) 5(2) Management Studies and Entrepreneurship Journal 5262, 5262-5266.

<sup>13</sup> Fadilah Sri, Maemunah Mey, Hernawati Nopi, 'Community Social Empowerment in Zakat Community Development (ZCD)' (2019) 35(2) MIMBAR Jurnal Sosial dan Pembangunan 460.

Islamic jurisprudence (fiqh), principles of jurisprudence (ushul fiqh), and exegesis (tafsir).<sup>14</sup> The epistemological and phenomenological approaches are integrated in this study to explore and propose the cultural and moral dimensions the legitimacy of zakat fund utilization and supervision.<sup>15</sup>

The research relies on primary data sources, including verbal and behavioral elements, as outlined by Lofland and cited by Lexy J. Moleong, supplemented by additional data.<sup>16</sup> To support the investigation in the practice of the normative and cultural framework of zakat supervision within Muslim society in a context of disclosure and transparency of zakat fund that lead to public trust.

Primary data sources include the International Zakat Core Principles, and juridical-regulative regulations, such as the Strategic Plans of the National Amil Zakat Agency (BAZNAS), Bank Syariah Indonesia, Islamic Bank of Thailand, Amanah Islamic Cooperative, Lembaga Negeri Zakat Kedah and Ibnu Affan Islamic Cooperative. This data encompasses information on these institutions' programs for managing zakat funds distributions, and profiles of pre-prosperous Islamic banking customers. It also involves examining the standard operating procedures for zakat distribution management, and successful case studies Zakat institutions.

Secondary data includes documents related to the standard of zakat fund distribution, literature from the field, and books or articles relevant to zakat distribution management in Islamic financial institutions.

Data collection techniques involve interviews with representatives from BAZNAS, Bank Syariah Indonesia, Islamic Bank of Thailand, Amanah Islamic Cooperative, Lembaga Negeri Zakat Kedah and Ibnu Affan Islamic Cooperative. Which is based on face-to-face meeting and telephonic conversation as long as it is convenient for the informants. Secondary data, including journal articles, books, and related archives, provide additional context for the research.

Data analysis includes a descriptive presentation of the collected data, starting with the exposition of responses from interviews and the written documents. The analysis employs both deductive and inductive methods to qualitatively assess the data. It begins with reviewing all pre-designated data from sources such as interviews and field notes, followed by data reduction through abstraction and detailed organization. Data categorization and scrutiny ensure accuracy, leading to a conclusive analysis addressing the research problem formulations.

### III. ISLAMIC FINANCIAL PRINCIPLES ON ZAKAT FOR ECONOMIC EMPOWERMENT

In 2020, the Islamic Research and Training Institute (IRTI) issued The Islamic Social Finance Report (ISFR) which identifies four pivotal components of Islamic social finance for the economic empowerment: Zakat, *Infaq*, Sadaqah, and Waqf. Also known in a short form as

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<sup>14</sup> Kabir Hassan and Aishath Muneeza, 'Islamic Economics' in Roy C. Amore and Albino Barrera (eds), *The Oxford Handbook of Religion and Economic Ethics* (Oxford: Oxford University Press 2024) 217–241.

<sup>15</sup> Sami Al-Daghistani, *The Making of Islamic Economic Thought: Islamization, Law, and Moral Discourses* (New York, Cambridge University Press 2022) 97-141.

<sup>16</sup> Moleong Lexy, *Metode Penelitian Kualitatif (in Indonesia) [Qualitative Research Method]* (Bandung: PT. Remaja Rosdakarya 2001) 40.



ZISWAF, these components are essential for integrating Islamic ethical principles into microfinance practices.<sup>17</sup>

ZISWAF are the key elements in Islamic philanthropy aiming at supporting the economic and social welfare. Zakat is an obligatory form of almsgiving, *Infaq* refers to voluntary spending in the way of Allah, Sadaqah includes any voluntary charity, and Waqf denotes endowments dedicated to public welfare.<sup>18</sup> Together, these mechanisms collectively provide financial services such as interest-free loans and savings accounts, which are critical in promoting financial inclusion and economic development in line with Sharia principles.<sup>19</sup>

In practice, Zakat is a mandatory for every Muslim to give 2.5% of their wealth for the charity. Some may argue that this system reduces income, but Muslims firmly believe that it will bring *barakah* (blessing) to their business and can alleviate poverty.<sup>20</sup> The term "Zakat" finds its etymological roots in words denoting purity, goodness, blessings, growth, and development.<sup>21</sup> In Islamic jurisprudence, Zakat signifies not only the purification and growth of wealth but also its blessings and expansion.<sup>22</sup> This concept implies that wealth subjected to Zakat will increase in purity and blessings, ultimately benefiting its possessor.<sup>23</sup> Technically, Zakat refers to the obligatory portion of wealth that a muzakki is required to distribute to eligible recipients as mandated by Sharia law.<sup>24</sup> Mustahik denotes individuals entitled to receive Zakat, specifically delineated as the eight categories found in the Qur'an, Surah At-Tawbah, verse 60.<sup>25</sup>

Zakat represents not merely a tax on revenue but fundamentally a levy on wealth. Its essential role resides in the equitable redistribution of resources, specifically addressing poverty within marginalized sectors of society.<sup>26</sup> Consequently, it carries substantial moral implications, intertwining with principles of social justice and envisioned solidarity among diverse socio-economic strata.<sup>27</sup> Zakat acts as a mechanism to encourage the active use of wealth, discouraging hoarding and promoting its circulation within the economy.<sup>28</sup> Roger Garaudy highlights the compulsory nature of Zakat, emphasizing that it is an obligatory contribution on accumulated wealth, aimed at purification and preventing the excessive concentration of resources.<sup>29</sup>

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<sup>17</sup> Islamic Research and Training Institute, 'Islamic Finance Report 2020' *Islamic Research and Training Institute (IRTI)* (Jeddah: 2020) <<https://irti.org/product/islamic-social-finance-report-2020/>> accessed on 14 July 2024.

<sup>18</sup> Husain Kamil, 'Contribution of Zakat and Community Economic Welfare' (2021) 2(1) *Indonesian Journal of Social Science Research* 39, 39-46.

<sup>19</sup> Setiawan (n 4) 222.

<sup>20</sup> Romi Adetio Setiawan and Agung Suwandaru, 'Risk of Islamic securities (SUKUK) and a proposed reforms for development: the Indonesian experience' (2024) 14(3) *Journal of Sustainable Finance Investment* 1, 1-5.

<sup>21</sup> Yusuf Qardhawi, *Fiqhus Zakat* (Beirut: Muassasah Risalah 1991) 10-27.

<sup>22</sup> Wahbah Zuhaili, *Al-Fiqh al-Islami wa Adillatuhu* (Beirut: Dar Al-Fikr al-Mu'as, 1999) 83.

<sup>23</sup> *ibid.*

<sup>24</sup> Qardhawi (n 21) 35.

<sup>25</sup> Qur'an, Surat At-Tawbah (The Repentance) 9:60.

<sup>26</sup> Qardhawi (n 21) 41.

<sup>27</sup> Setiawan and Suwandaru (n 20) 8.

<sup>28</sup> Zuhaili, (n 22) 80.

<sup>29</sup> Roger Garaudy, *Mencari Agama pada Abad XX: Wasiat Filsafat Roger Garaudy* (Jakarta: Bulan Bintang 1986), 95.



#### IV. ZAKAT CORE PRINCIPLES

The Zakat Core Principles for effective zakat management and supervision were introduced in May 2016, led by the Islamic Research and Training Institute (IRTI), BAZNAS, and the Central Bank of Indonesia. These principles aim to establish a standardized framework for zakat institutions globally, ensuring consistency, transparency, and efficiency in zakat management. Their primary objective is to enhance public trust in zakat systems and maximize the impact of zakat funds on poverty alleviation and economic empowerment.<sup>30</sup>

The principles build on the Basel Core Principles (BCPs) but are adapted to suit the specific context of zakat supervision. The BCPs primarily address financial reporting and institutional governance, which are relevant to zakat management, although some principles from the BCPs do not apply to zakat supervision.<sup>31</sup> For instance, principles related to consolidated supervision and home-host relationships are less relevant. However, several principles are directly adapted: they cover aspects such as the objectives, independence, and powers of zakat supervisory bodies, permissible activities, licensing criteria, and supervisory techniques. Additionally, they address governance, risk management, zakat collection and disbursement, internal controls, Sharia compliance, financial reporting, and transparency.<sup>32</sup>

Regulation	1. Objective, Independence and powers
	2. Permissible activities
	3. Licensing Criteria
Supervision	4. Supervisory approach
	5. Supervisory technique and tools
	6. Supervisory Reporting
	7. Corrective and Sanctioning Power of Zakat Supervisor
C&D Management	8. Good Amil Governance
	9. Collection Management
	10. Disbursement Management
Risk Management	11. Country and Transfer Risk
	12. Reputation and Muzakki Loss Risks
	13. Disbursement Risk
	14. Operational Risk
Audit & Transparency	15. Sharia control and internal audit
	16. Financial reporting and external audit
	17. Disclosure and Transparency
	18. Abuse of zakat services

Table 1: Zakat Core Principles (Source: adopted from the consultative document: Core Principles for Effective Zakat Supervision)

The table 1, provides a detailed risk management framework for zakat institutions, emphasizing the need to address five categories for effective zakat supervision which are regulation, supervision, collection and disbursement management, risk management and audit and transparency. These categories representing the 18 Zakat Core Principles which involve aligning the institution's mission with long-term goals while preventing reputational damage.

<sup>30</sup> International Working Group on Zakat Core Principles (n 8) 1-17.

<sup>31</sup> *ibid.*

<sup>32</sup> *ibid.*

Indeed, together these principles are formed to build a comprehensive approach in managing the diverse risks inherent in zakat administration.<sup>33</sup> However, the system of zakat core principles misses to include the social behaviour as one of its core principles. In Islamic social behaviour, every Muslim can be expected as a volunteer in disseminating the kindness for zakat fund. If the recipient of zakat deceits and does not match the *mustahik* categories, the other *mustahik* are likely to report him to the *muzakki* or zakat institution, he will then be accused of ingratitude which serves as a kind of social control for zakat supervision.

In addition to serving as a fundamental reference for zakat institutions, the zakat core principles tend to overlook the role of Muslim society networks as public supervisory agents. In practice, the disbursement of zakat funds is susceptible to conflicts of interest, including political misuse, especially when oversight and transparency mechanisms are inadequate.<sup>34</sup> Zakat, intended for social welfare and poverty alleviation, should be used according to its purpose. However, there have been cases where political figures or groups have misused zakat funds to gain political support or consolidate power, undermining its ethical use and primary objectives. As Khan and Qutub explain that:

“Zakat and *Ushr* has undertaken a number of implementation reforms...It should be noted that most of these reforms reflect policy decisions, and it is unclear whether there is bureaucratic commitment or political interest in ensuring their implementation.”<sup>35</sup>

It is a common problem where the political leaders have allegedly directed zakat funds to certain constituencies during electoral campaigns in exchange for votes. To mitigate such risks, leveraging social Islamic networks for oversight can be effective. These networks can act as supervisory agents, applying social and economic sanctions to dishonest zakat administrators. Greif argues that social networks can deter opportunistic behaviour through ostracism and other informal sanctions.<sup>36</sup> The same principle applies to humanitarian relief workers, who utilize public networks to promote consensus on normative standards and enforce shared norms in crisis or war-affected regions. Similarly, in Islamic societies, public networks serve as a supervisory mechanism to ensure that zakat funds are properly utilized.<sup>37</sup> This informal oversight is crucial for maintaining trust and adherence to Sharia principles.

## V. ZAKAT CASE STUDIES – ISSUES IN RISKS

The Muslim prominent scholars account for effective zakat management based on financial report and focus on institutional development.<sup>38</sup> While it is considered as essential aspect of Islamic financial systems, zakat management faces various risks that can impact the effectiveness and credibility of zakat institutions. Case studies, such as the failure of Yayasan Aksi Cepat Tanggap (ACT) in Indonesia and the success of Lembaga Zakat Negeri Kedah (LZNK) in Malaysia, offer valuable insights into the challenges and best practices in zakat risk

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<sup>33</sup> *ibid.*

<sup>34</sup> Shanza Khan and Sara Qutub, 'The Benazir Income Support Programme and the Zakat Programme: A Political Economy Analysis of Gender' *Overseas Development Institute* (London: November 2010) <<https://odi.cdn.ngo/media/documents/7247.pdf>> Accessed 23 June 2024.

<sup>35</sup> *ibid* 24.

<sup>36</sup> Greif (n 9) 528.

<sup>37</sup> Alamad, (n 3) 28.

<sup>38</sup> International Working Group on Zakat Core Principles (n 8) 1-17.

management. These examples describe the necessary of strong risk management strategies in enhancing the efficiency and integrity of zakat distribution.



Figure 1: Risk and regulation of zakat

As depicted in Figure 1, field research has identified at least four key risks associated with zakat management. These risks include: (1) the absence of regulations governing the supervision of zakat funds through Islamic social networks, (2) inadequate oversight of zakat funds, (3) reputational risk, particularly concerning the lack of public trust in zakat institutions, and (4) the risk of losses associated with the use of zakat funds for investment purposes.<sup>39</sup>

#### A. Risks and Regulations in Zakat Management

Zakat management faces several critical risks, particularly related to regulatory compliance and oversight. The absence of clear regulations for supervising zakat funds through Sharia-compliant mechanisms introduces significant operational uncertainties for zakat institutions. This lack of regulatory clarity can lead to challenges in managing complex financial systems, potentially resulting in inefficiencies or misuse of funds. According to Mukhlisin at al:

“The implementation of economic empowerment is a contextual interpretation of government regulations regarding philanthropy for the welfare of the community. With this motion, there is public enthusiasm for distributing money or donations to managers freely and institutions can professionally channel philanthropic funds.”<sup>40</sup>

In Indonesia, zakat management is governed by Law No. 23 of 2011 on Zakat Management. However, the law does not provide detailed guidance on implementing effective oversight mechanisms, leaving gaps in regulatory enforcement and oversight.<sup>41</sup> This regulatory ambiguity enables zakat institutions to collect funds with insufficient oversight regarding their allocation, thereby increasing the risk of mismanagement.<sup>42</sup>

For example, the Islamic Financial Institutions in Indonesia often channelled their zakat fund to the third parties (such as Baitul Maal Institutions) instead of doing it on their own, like Baitul

<sup>39</sup> *ibid.*

<sup>40</sup> Mukhlisin Mukhlisin, Khudzaifah Dimiyati, Absori Absori, Jelang Ramadhan, Dinil Sulthani, ‘The Effect of Indonesia Philanthropy’s Regulation Towards the Welfare State’ (2022) 1(2) *Bestuur* 123, 127.

<sup>41</sup> Mukhlisin (n 40) 123.

<sup>42</sup> *ibid.*

Maal Hidayatullah (BMH) associated as the third party of Bank Syariah Indonesia and Baitul Maal Muamalat (BMM) linked to Bank Muamalat. The lack of stringent regulatory frameworks means that these funds are not adequately monitored, potentially leading to their exploitation for promotional purposes by financial institutions amidst the challenges faced by small communities or zakat recipients.<sup>43</sup>

Weak oversight mechanisms further exacerbate the risk of misuse, particularly by individuals or groups with political interests. In several countries, including Indonesia, zakat institutions often operate with minimal direct supervision from financial bodies or government entities, which heightens the risk of corruption and manipulation. As described by Bremer:

“While there is no theoretical reason why a government-run zakat program could not engage in Z4D, the history of such organizations strongly suggests that they lack the business knowledge and flexibility to be successful in such an endeavor. Public zakat institutions also appear to be regrettably deficient in accountability, transparency, and lack of bias, all of which would be essential to prevent Z4D programs from turning into sinkholes of corruption.”<sup>44</sup>

Consequently, the case of Yayasan Aksi Cepat Tanggap (ACT) illustrates how inadequate oversight and transparency can result in substantial financial losses and erode public trust.<sup>45</sup> ACT, one of Indonesia’s largest philanthropic organizations, had built a strong reputation through its extensive social and humanitarian programs. Despite this, the organization faced a significant crisis in 2022 when investigations revealed severe weaknesses in its zakat and philanthropic management.<sup>46</sup> The findings indicated that a substantial portion of the humanitarian funds was misappropriated for personal use by senior officials, including luxury purchases and operational expenditures unrelated to the organization’s mission. This misuse of funds highlighted critical failures in maintaining the integrity and trust of donors.<sup>47</sup>

A major criticism of ACT was its lack of financial transparency. The unavailability of public financial reports created uncertainty regarding fund allocation and program outcomes. The absence of accessible financial information exacerbated the crisis and diminished confidence in ACT’s management.<sup>48</sup> Furthermore, weak internal controls and the lack of regular external audits allowed fund misuse to go undetected. ACT’s insufficient oversight mechanisms facilitated corruption and manipulation without effective checks.<sup>49</sup>

The involvement of political interests further complicated the situation, with indications that funds were used for political purposes by certain individuals within ACT. Thus, ACT violated Law No. 28 of 2004 concerning foundations, specifically regarding the foundation's assets, which are prohibited from being distributed in any form to the foundation's trustees or

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<sup>43</sup> Setiawan (n 4) 222.

<sup>44</sup> Jennifer Bremer, ‘Zakat and Economic Justice: Emerging International Models and their Relevance for Egypt’ (Third Annual Conference on Arab Philanthropy and Civic Engagement, Tunisia, 2015) 51-74, 69.

<sup>45</sup> Levianto (n 12) 5262.

<sup>46</sup> *ibid.*

<sup>47</sup> Indah Rosalina and Nabilah Nurlaely, ‘Penyelewengan Dana Donasi ACT dalam Bingkai Kompas TV’ (2023) 2(1) *Daruna: Journal of Communication* 13.

<sup>48</sup> Levianto (n 12) 5262.

<sup>49</sup> Rosalina and Nurlaely (n 47) 18.

1 management. This added a dimension of abuse, undermining public trust and exposing serious conflicts of interest.<sup>50</sup>

The ACT case underscores the urgent need for robust regulatory frameworks and oversight mechanisms in zakat management. Ensuring effective transparency, strong internal controls, and independent audits are crucial for preventing misuse and maintaining public confidence.<sup>51</sup> Additionally, stringent government regulations are necessary to ensure accountability and proper allocation of zakat funds. Educating the public about the importance of supporting transparent and accountable zakat institutions is also vital. The ACT case serves as a stark reminder of the importance of sound risk management practices to safeguard the integrity and impact of zakat programs.<sup>52</sup>

## B. Enhancing Zakat Management: Strategies for Success

In the context of zakat management, it is crucial for zakat institutions to implement vigorous risk management practices. Strengthening regulatory frameworks and compliance is a fundamental first step. Regulations should encompass provisions for external public supervision, alongside procedures to ensure transparency and accountability in the management of zakat funds. Collaborative efforts between government bodies and Sharia-compliant financial institutions are necessary to establish clear standards and ensure adherence to existing regulations.<sup>53</sup>

Effective oversight and transparency are critical components of risk management. Zakat institutions must implement robust internal monitoring systems and be subject to external supervision by independent auditors or regulatory bodies. Alamad notes “An effective and transparent risk governance structure is fundamental to ensure an efficient risk management framework in IFI”.<sup>54</sup> Transparency in financial reporting and public communication is essential for building public trust and preventing corruption.

An illustrative case is the zakat account program implemented by the Islamic Bank of Thailand which is fully supervised and controlled. Unlike the practice in Indonesia, where Islamic banks channel zakat funds directly to third parties such as Yayasan Baitul Mal without further oversight from the financial authorities, the Islamic Bank of Thailand maintains zakat funds within the bank, under the supervision of the Financial Services Authority. This setup ensures that all zakat fund allocations are transparently reported and disclosed to customers, thereby enhancing oversight and accountability.<sup>55</sup>

Reputation management requires a focus on ethical and accountable practices. Zakat institutions should uphold high ethical standards and ensure that all activities and decisions related to zakat fund management are conducted transparently. In business relations, indeed being responsive to public feedback and criticism are crucial steps in maintaining a positive reputation.<sup>56</sup>

Consequently, the distribution of zakat fund should adhere the sharia principles so as to ensure the sharia compliant risk. Zakat institutions should comprehensively view that Sharia give

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<sup>50</sup> *ibid.*

<sup>51</sup> Levianto (n 12) 5265

<sup>52</sup> *ibid.*

<sup>53</sup> Alamad (n 3) 28.

<sup>54</sup> *Ibid* 265.

<sup>55</sup> Wahyudi (n 10) 122.

<sup>56</sup> *ibid.*

guidance to Muslims to respect the moral and ethical behaviour, this basis also inline insuring that zakat fund is managed with thorough risk assessments and in accordance with established policies. Regular evaluations and ensuring that zakat funds are directed towards productive purposes are essential for minimizing the risk of financial losses.<sup>57</sup>

### C. Case Study: Best Practices in Zakat Management

The robust risk management practices is exemplified by the Lembaga Zakat Negeri Kedah (LZNK) which is renowned for its effective and transparent management of zakat funds. Zakat institutions are required to operate under stringent regulations that govern zakat administration and ensure compliance with Sharia principles and high accountability standards.<sup>58</sup> The institution's strong internal oversight system and regular external audits contribute significantly to maintaining transparency and accountability.

In term of building public relationship, LZNK's success can be attributed to its improved efficiency and the distribution process. Zaki, Sulong and Zainal describe:

“LZNK is also collaborating with several public higher education institutions (IPTA) and other institutions to obtain input and ideas on existing mechanisms and strategic planning for the potential distribution of educational zakat in the future”.<sup>59</sup>

Zakat distribution should adhere the regulations, since adherence to clear regulatory frameworks can establish comprehensive procedures for zakat collection, distribution, and reporting. These regulations are designed to ensure that all zakat activities align with Sharia law and meet high standards of accountability. For example, LZNK adheres to specific guidelines for auditing and reporting, as evidenced by the documented procedures provided by the institution.<sup>60</sup>

The institution's internal monitoring system includes rigorous financial audits conducted by independent third parties. These audits, alongside regular performance evaluations and oversight by an independent board, enhance transparency and build public trust.<sup>61</sup> LZNK's commitment to transparency is further demonstrated through its routine publication of financial reports, which detail the allocation of zakat funds and the outcomes of its programs. This level of openness allows the public and donors to scrutinize how their contributions are utilized, thereby fostering trust and credibility.<sup>62</sup>

By providing comprehensive and easily accessible information, Lembaga Zakat Negeri Kedah (LZNK) can establish trust and credibility in the eyes of the public. The three elements

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<sup>57</sup> Bremer (n 44) 55.

<sup>58</sup> Hanudin Amin, 'New measures of Islamic social finance receptiveness index' (2024) ahead-of-print (ahead-of-print) *Journal of Economic and Administrative Sciences* 1, 1-13.

<sup>59</sup> Mohamad Muhaimin Mohamad Zaki, Jasni Sulong and Hafizah Zainal, 'Penentuan Skim Agihan Zakat Pendidikan Kajian Di Lembaga Zakat Negeri Kedah (LZNK)' (2021) 1(2) *Azka International Journal of Zakat Social Finance* 123, 124.

<sup>60</sup> Nur Zainie, Rosman Hasyimah and Ibrahim Shamsinar, 'Mekanisma pemantauan: memperkukuhkan pengurusan agihan zakat wakalah oleh lembaga zakat negeri Kedah (LZNK)' (2022) 4(1) *International Journal of Business Economy* 177, 177-179.

<sup>61</sup> Zaki, Sulong and Zainal (n 58) 123.

<sup>62</sup> *ibid.*



discussed earlier are pivotal to LZNK's success in managing zakat funds, as illustrated in Figure 2 below.

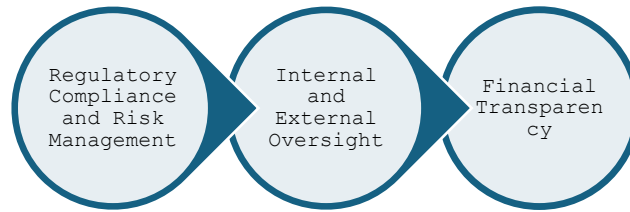


Figure 2: The Three Key Elements of Successful Zakat Fund Management at LZNK (source: adopted from [www.zakatkedah.com.my](http://www.zakatkedah.com.my))

In addition to transparency, LZNK emphasizes reputation management by upholding high ethical standards and maintaining clear communication with the public and donors. The institution actively responds to feedback and criticism, using digital platforms to share success stories, testimonials, and detailed reports of its activities. This proactive approach helps sustain its positive reputation and strengthen donor relationships involving the normative and cultural frameworks in Islamic society.<sup>63</sup>

LZNK also excels in economic empowerment initiatives, focusing on improving the welfare of impoverished communities through various programs funded by zakat. These programs include skills training, business grants, and business mentorship, which are aimed at enhancing self-sufficiency and raising living standards. LZNK collaborates with educational institutions, NGOs, and the private sector to deliver these programs, which span sectors such as agriculture, fisheries, small trade, and creative industries.<sup>64</sup>

LZNK's achievements in improving the welfare of the poor in Kedah reflect its effective economic empowerment programs. The positive impact is evidenced by increased community participation and donor confidence, which, in turn, supports substantial zakat collections and beneficial programs. LZNK's reputation as a transparent and accountable zakat institution serves as a model for other organizations, demonstrating that adherence to Sharia principles and high accountability standards can lead to significant societal benefits and public trust.<sup>65</sup>

In summary, the success of Lembaga Zakat Negeri Kedah (LZNK) highlights the importance of risk management, transparency, and accountability in zakat administration. With strong regulatory frameworks, effective oversight, and transparent financial reporting, LZNK has built public trust and enhanced the welfare of zakat recipients. The best practices implemented by LZNK offer valuable insights for other zakat institutions, underscoring the potential for achieving significant social impact and maintaining public confidence through diligent adherence to Sharia principles and high standards of accountability.

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<sup>63</sup> *ibid.*

<sup>64</sup> *ibid.*

<sup>65</sup> Zainie, Hasyimah and Shamsinar (n 60) 177.



## VI. RISKS AND REGULATIONS IN ZAKAT MANAGEMENT

Weak regulatory frameworks contribute to non-standard practices in the management of zakat funds, complicating efforts to ensure that these funds are managed effectively and efficiently. According to Mukhlisin et al. “The purpose of philanthropy regulation is to improve social welfare, particularly in maintaining the quality of life”.<sup>66</sup> The absence of strong regulations creates opportunities for some institutions to exploit zakat funds without adequate oversight.

In Indonesia, the situation of minimal supervision is further exacerbated as evidenced by the cases of channelling donation fund to the third parties outsourcing management which is done by Islamic banks. This system considered as inferior, since it is done without sufficient oversight from the financial institutions themselves.<sup>67</sup> Consequently, zakat funds are sometimes used for institutional promotion or even political interests, undermining public trust.<sup>68</sup> The trust of the public is crucial for the sustainability of zakat collection and distribution. When the public perceives that zakat funds are not managed transparently and effectively, they may become reluctant to channel their zakat through such institutions. In Thailand, the Islamic Bank itself managed the zakat funds through dedicated zakat account, this practice can minimize the lack oversight by the financial authorities.<sup>69</sup> In this model, zakat funds remain within the Islamic financial institution and are overseen by financial regulatory authorities (the central bank and ministry of finance).<sup>70</sup> To ensure that the distribution of zakat funds comply with sharia principles, it requires approval from a Sharia Committee, ensuring that funds are allocated appropriately.<sup>71</sup>

Indeed, empirical case from Islamic bank of Thailand can help to somewhat mitigate the illegitimate zakat distribution, suggesting that this could improve public trust in zakat institutions, ultimately boosting zakat collection and its impact on those in need. As further described by Hassan and Muneeza that implementing stricter regulations, improving supervision, and increasing transparency could significantly enhance zakat management.<sup>72</sup>

However, strict regulation alone is not enough; there must also be thoughtful supervision that continually upholds structural normativity. Zakat supervision frequently involve wide networks of individuals who voluntarily act as intermediaries to their communities in overseeing the zakat collection and distribution. In this sense, any illegal activities intended by the zakat institutions - such as manipulation, corruption and illicit transfers - can be evidenced through the help of reports from within the Muslim community. Therefore, the role of normativity in effective zakat supervision is crucial. As Ercanbrack explains, incorporating normativity in informal financial institutions bears no economic cost, as the moral and ethical behaviour has been embedded historically and culturally in Islamic society itself.<sup>73</sup>

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<sup>66</sup> Mukhlisin (n 40) 130.

<sup>67</sup> Dikuraisyin and Dayanti (n 6) 15.

<sup>68</sup> Khan and Qutub (n 33).

<sup>69</sup> Vladimir Malenko, ‘Islamic banking in Thailand: On the Path of Recovery’, *Medium* (Bangkok: 30 June 2022) <<https://malenko.medium.com/islamic-banking-in-thailand-on-the-path-of-recovery-5a5db3cef9bb>> Accessed on 23 July 2024.

<sup>70</sup> Asma Sitthivanich and Rusni Hassan, ‘An Analysis of the Islamic and Conventional Banking Regulatory Bodies and Legislation in Thailand’ (2017) 5(2) *Journal of Islamic Banking and Finance* 2374.

<sup>71</sup> *ibid.*

<sup>72</sup> Hassan and Muneeza (n 14) 217.

<sup>73</sup> Ercanbrack (n 5) 21.

## VII. CONCLUDING REMARKS

It is obvious that sometimes it appears the profit-oriented perspective overlooks the normative characteristics. In Islam there should be interplay between material and spiritual goals in economic activities. The pursuit of *falah*—a concept denoting success and nobility—underpins the broader objectives of Islamic economic practices, extending beyond mere material gains to encompass spiritual and social welfare.

Based on our exploration of literatures in the field of zakat management, there is significant gaps in the regulatory and supervisory frameworks governing zakat distribution, particularly in Indonesia. The study underscores the crucial role of robust regulation and effective supervision in mitigating risks associated with the misuse of zakat funds. The inadequacies in these areas, as identified, often lead to inefficiencies and potential exploitation, thereby undermining the integrity of zakat institutions and eroding public trust.

The findings suggest that, although the financial reporting systems and institutional frameworks, as advocated by the International Working Group on Core Principles for Effective Zakat Supervision and Greif's Multilateral Reputation-Based Mechanism (MRM), are fundamental, they are insufficient on their own. The incorporation of normative and cultural dimensions that oversight zakat within Muslim societies is essential for a more comprehensive approach to zakat supervision. This perspective aligns with the observations made by researchers such as Ercanbrack, Wahyudi et al. and Kafabih, who emphasize the need for robust reporting but also highlight the limitations of current frameworks.

This research finds that the analysis of international practices, such as those implemented by the Islamic Bank of Thailand and Lembaga Zakat Negeri Kedah, provides valuable insights into effective zakat management and supervision. These case studies demonstrate the benefits of stringent regulation, enhanced supervision of zakat fund by the financial authorities, and improved transparency where every individual's eye is acting as intermediaries in overseeing zakat management. By adopting similar practices, zakat institutions in Indonesia can address existing challenges, improve the efficiency of zakat distribution, and restore public confidence.

In conclusion, this paper advocates for a holistic approach to zakat management that integrates both financial and normative considerations. By strengthening regulatory frameworks, enhancing supervisory mechanisms, and incorporating cultural and religious factors, zakat institutions can achieve greater transparency and effectiveness. These measures will not only enhance the impact of zakat on socio-economic development but also reinforce the public's trust in zakat institutions, ultimately contributing to the broader goals of Islamic economic principles. Future research should continue to explore and refine these approaches, ensuring that zakat management evolves to meet both material and spiritual objectives in an increasingly complex global context.

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