

Manchester Journal of Transnational Islamic Law & Practice

About

The Manchester Journal of Transnational Islamic Law & Practice (formerly the Journal of Islamic State Practices in International Law) was founded in 2005. The Journal is independent of any State, school of fiqh or institutional affiliation and has a diverse and global editorial board. It is indexed on Scopus and available both in electronic and printed forms.



Aims of the Journal

The principal objectives of the Manchester Journal of Transnational Islamic Law & Practice (MJTILP) are to provide a vehicle for the consideration of transnational forms of Islamic law and practice. Transnationalism in Islamic law is taken broadly as communications and interactions linking Islamic thoughts, ideas, people, practices and institutions across nation-States and around the globe. In recent times, research in Islamic law has shaped narratives based on nation-States, demographics, diasporic communities, and ethnic origins instead of developing around a central core. Contemporary issues of Islamic law are increasingly linked to geographical locations and ethnic or parochial forms of religious beliefs and practices. Expressions like American, European, British, Asian, and Arab Islam have widely gained acceptance.

Despite the growing importance of dialogue to develop shared understandings of issues facing Islamic law and proposing coordinated solutions, the contemporary research and scholarship has not developed harmoniously and remains piecemeal and sporadic. Researchers and practitioners of Islamic law are drawn from a wide variety of subjects and come from various regions of the world but have insufficient institutional support for sharing information and comparing experiences. Innovation in various strands and paradigms of Islamic law and practice is stifled because there are limited spaces where evolutionary, collaborative and interdisciplinary discourses can take place. This in turn hampers the ability to build on past research and record best practices, negatively impacting a consistent and orderly development of the field. There is a need to constitute a world community of Islamic law scholars based on interactions and aspirations moving across linguistic, ethnic, geographical and political borders.

The MJTILP is inspired by the need to fill these gaps. It provides a platform to legal and interdisciplinary scholars and researchers for critical and constructive commentaries, engagements, and interactions on Islamic law and practice that are built upon configurations in contemporary contexts. It welcomes contributions that look comparatively at Islamic law and practice that apprise and inspire knowledge across national boundaries whether enforced by a State or voluntarily practiced by worldwide Muslim communities. We are equally interested in scholarships on encapsulated cultural worlds, diaspora, identity and citizenship that are embedded and circumscribed by religious ties. As it has been the practice of the journal since its establishment in 2005, it also has a specific interest in issues relating to the practice of Muslim States in international law, international law issues that may concern Muslim countries, and all aspects of law and practice affecting Muslims globally.

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Contents

Articles:

The Concept and Essentials of Unstable Ownership and Its Effects in Imami Jurisprudence and Iranian Law

Mohammad Hosein Vakili Moghadam 1

A Comparative Analysis between the Implications of Paradigm and Ijma for the Cognition Element

Fatemeh Rezaei, Sayyed Mohammad Hadi Gabooli Dorafshan, Alireza Azad, Alireza Abedi Sarasia 19

Political Configuration and Characteristics of Legal Products of Islamic Law Based Reforms in Indonesia under the BJ Habibie Administration

Ibnu Radwan Siddik Turnip, Muhamad Hasan Sebyar 34

Ensuring Restorative Justice Through Penal Mediation in Indonesia: An Examination from the Perspective of Islah (Reformation) in Islamic Criminal Law

Joko Sriwidodo 45

Article 9 of the Constitution of Pakistan: The Right to Life or Substantive Due Process?

Amr Ibn Munir 58

Islamic Law As A Source of Legal Rules in the MENA Region

Maged Mamdouh Shebaita 78

Breaking the Glass Ceiling: A Semiotic Qualitative Study of Ellen Soebiantoro's Tenure as Indonesia's First Muslim Female Deputy Attorney General

Helena Octavianne, Fendy Suhariadi, Mohammad Fakhruddin Mudzakkir, Mia Amiati, Muhammad Ali Adriansyah 91

Female Madrasas and Islamic Agency of Afghan Girls and Women: How Religious Education is Being Used by Afghan Women and Girls under the Taliban Regime

Haroun Rahimi, Faiza Muhammad Din 101

Critical Analysis of the Legality of Kuwait's Boycott of Israeli Trademark in Light of TRIPS Agreement

Nawaf Alyaseen 119

Performing Salah in the Metaverse: Analysing the Perspectives of Ahl al-Hadith and Ahl al-Ra'yi within the Intersection of Technology and Religion

Mursyid Fikri, Indriana 135

Legal Protection for Non-Halal Traditional Culinary in Indonesia: Cultural, Religious and Economic Perspectives <i>Riana Susmayanti</i>	144
Between Reality and Aspiration: A Critical Review of the Principle of Judicial Independence Considering the Algerian Constitutional Amendment of 2020 <i>Samia Abdellaoui</i>	155
Preventing Child Marriage in Lampung: An Analysis of the Community Embedded Implementation Process Adopted for the Provincial Regulation Number 55 of 2021 and its Harmonisation with Local Custom and Islamic Law <i>Rohmadi</i>	165
Utilisation of Mosque Funds for Public Welfare Based on Maqasid al-Shari'ah Perspectives <i>Abdul Wahid Haddade, Sudirman, Abd. Rauf Muhammad Amin</i>	177
Examining the Role of Media in Raising Awareness of the Law and Practice of Endowment (Waqf): A Comparative Analysis of Islamic and Western Endowment Systems <i>Maryam Almansoori, Moath Alnaief, Aziz Farhan Al-enezy</i>	190
Determinants of Performance of Insurance Companies having Window Takāful Operations in Pakistan <i>Hafiz Rauf Iqbal, Muhammad Asghar Shahzad, Hafiz Ghulam Abbas, Muhammad Akmal</i>	202
Legal Challenges of Prosecuting War Crimes and Crimes Against Humanity: A Comparative Analysis of Islamic Law and Modern International Law <i>Nehaluddin Ahmad, Faizah Rahim, Danish Iqbal Ariffin</i>	216
Islamic and Christian Law on the People of Dhimmahh (non-Muslims Residing in an Islamic State): A Historical Comparative Analysis Drawn from Adam Metz's 'The Renaissance of Islam' <i>Yousif K. Al-Shimmary, Hamed Abd Al-Hamza Al-Janabi</i>	248
The Evolution of Sijuju' Sulo (Fire War) Tradition: A Maqāsid al-Shari'ah Perspective of the Socio-Cultural Practices in Indonesia's Pongka Village <i>Abdul Syatar, Andi Muhammad Awaluddin Arfah</i>	266
Sharing Interfaith Inheritance in Muslim Communities Based on Maqasid al-Shariah <i>Im Fahimah</i>	278
Integrating Maqasid al-Shariah into Legal Policies for Hybrid Working: Enhancing Flexibility and Protecting Employee Rights in Indonesia <i>Sapto Hadi Pamungkas, Sangga Aritya Ukkasah, Mu'adil Faizin</i>	287
Synergising Normative and Cultural Frameworks in Reforming Core Principles for Effective Zakat Supervision in Indonesia <i>Nurul Hak, Romi Adetio Setiawan, Adi Setiawan</i>	302

Can Cryptocurrencies Save Islamic Finance?	
<i>Frank Emmert</i>	317
Special Section on Recent Legal Developments in Egypt (Edited by Yasmine Abdel Moneim):	
Introduction to the Special Section on Recent Legal Developments in Egypt	
<i>Yasmine Abdel Moneim</i>	346
Evolving Jurisprudence of Supreme Constitutional Court of Egypt on Religious Institutions	
<i>Mohamed R. Abdelsalam</i>	350
Protecting the Rights of Children Without Parental Care in Egypt: A Review from the Perspectives of Islamic Law and UN Instruments	
<i>Fady Habashy</i>	355
Combating Discrimination in Egypt Since The 2014 Constitution	
<i>Ahmed Abdalla Elkholy</i>	363
Quantum Computing and Islamic Banking: Legal Framework for Transforming Egypt's Financial Sector	
<i>Ahmed Mokhtar Elmansy</i>	369
Confidentiality and Privacy in Personal Data Processing: An Analytical of Islamic Law and Egyptian Law No. 151 of 2020	
<i>Ahmad Saeed Ezzat</i>	375
The Impact of Islamic Law on Cryptocurrency Regulation in Egypt	
<i>Hesham M. Abdelgawad</i>	381
The Philosophy of Punishment in Intellectual Property Rights Law: A Comparative Analysis of Emerging Technological Crimes Under Egyptian and Islamic Law	
<i>Abdallah Mohamed Nour El Dien</i>	389
Special Section on Recent Legal Developments in Malaysia (Edited by Mohamad Janaby):	
Introduction to the Special Section on Recent Legal Developments in Malaysia	
<i>Mohamad Janaby</i>	396
Application for Declaration of Religion's Status in Malaysian Shariah Court: An Analysis on the Judge's Approach Within the Purview of Maslahah	
<i>Mohd Lotpi bin Mohd Yusob, Abdul Karim bin Ali</i>	399
Statelessness of Non-Marital Children in Malaysia: Contemporary Perspectives on Shariah and Law	
<i>Rodziana Mohamed Razali, Aishah Mohd Nor</i>	404

Transnational Marriages of Rohingya Refugees: Legal Challenges of Islamic Family Law in Malaysia

Rodziana Mohamed Razali, Aizat Khairi, Tasneem Rahmatullah 412

Protecting Gig Workers in the Digital Labour Platform Through the Principles of Social Justice in Islam

Siti Suraya Abd Razak 420

Regulatory Reform to Strengthen Islamic Consumer Credit Business in Non-Banking Sector: The Case of Malaysia

Ibtisam @ Ilyana Ilias 425

The Role of Integrating AI-Powered Predictive Analytics in Arbitration for Resolving Islamic Banking Disputes

Mohamad Fateh Labanieh, Mohammad Azam Hussain, Muhammad Habibi Miftakhul Marwa, Hizri Hasshan 432

A Framework for Waqf-Linked Sukuk to Develop Idle Waqf Land in Malaysia

Mohamed Ayaz Mohamed Ismail, Aishath Muneeza, Magda Ismail Abdel Mohsin 438

Applying Hibah Trusts in Estate Planning: A Model for Malaysian Islamic Financial Institution

Mohd Izzat Amsyar Mohd Arif, Shofiyah Moidin, Mohd Afandi Mat Rani, Faezy Adenan 443

Combatting Ah Long Syndicates: Towards a Shari'ah-Compliant Legislative Framework for Financial Integrity in Malaysia

Nehaluddin Ahmad, Zheimie H. Zamri 449

Navigating the Paradigm Shift in Malaysia's Sustainable Responsible Investment Sukuks

Zakariya Mustapha, Sherin Kunhibava, Aishath Muneeza, Maryam Khalid 457

Abolishing the Death Penalty: A Crucial Legal Reform in Malaysia's Criminal Justice and Islamic Law

Mohd. Wasim Ali, Khalid Khan 465

Integrating Islamic Principles in Competition Law to Tackle the Challenge of Monopolies in Malaysia

Hatijah Mohamed Salleh, Khairunnisa Ishak, Farhana Hanim Mohsin, Norhayati Md Isa 470

Book Reviews:

***The Racial Muslim: When Racism Quashes Religious Freedom* Sahar F. Aziz (Author), John Esposito (Foreword), University of California Press, 2021, 365 p. ISBN: 9780520382299**

Md Asif Belal Ansari 476

***Peace and Reconciliation in International and Islamic Law* Kaleem Hussain, Cambridge Scholars Publishing, 2023, xix + 142 pp. ISBN: 978-1-527-50187-4.**

Tahir Ahmed Wani 479

Synergising Normative and Cultural Frameworks in Reforming Core Principles for Effective Zakat Supervision in Indonesia

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Abstract: In recent years, the International Working Group led by the Islamic Research and Training Institute has developed guidelines known as the Zakat Core Principles for effective Zakat supervision. While these efforts represent significant progress and are widely adopted in the Islamic world, we argue that the efforts miss a key piece of the cultural and moral normative frameworks by not examining how Muslim public's support could influence the effectiveness of alternative supervision methods. In environments where transparency and disclosure are prioritised, these cultural and moral norms play a crucial role in differentiating between legitimate and illegitimate zakat transactions. However, the International Working Group primarily emphasises financial reporting and institutional development, which often overlook these cultural and moral dimensions essential for effective zakat supervision. This article 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 considered 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 financial endeavours.¹ Hence, the objective and achievement of economic pursuits in Islam revolve around attaining *falah*. *Falah*, stemming from the derivation of the word *aflaha* using

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¹ 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.

the verb *fi'il mādhi*, connotes success, nobility, and triumph.² Therefore, the multidimensional nobility inherent in engaging in economic activities within an Islamic framework extends focus solely on material gains, encompassing spiritual achievements and considerations for the afterlife.³

Zakat, a fundamental pillar of Islamic finance, plays a crucial role in this framework. It is deeply embedded in social relationships between *muzakki* (giver) and *mustahik* (recipient), reflecting a system that persists globally due to its social and ethical dimensions.⁴ 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.⁵ In developed economies, similar unregulated transactions are frequently classified as criminal due to risks such as money laundering or fraud.⁶

Dikuraisyin and Dayanti highlighted three challenges encountered in allocating zakat funds: Initially, the complexity revolves around assessing the economic advancement of recipients (*mustahik*).⁷ This challenge stems from the prevailing approach to distribution practices 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 ineffective 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.⁸

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.⁹ 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

² Muhammad Fu'ad 'Abd al-Baqi, *Al-Mujam al-Mufahras li Alfaz Al-Qur'an al Karim* (in Arabic) [The Indexed Lexicon of the Words of the Noble Qur'an] (Cairo: Dar al-Kutub al-Misriyya 1945) 526.

³ Makhrus Ahmadi, 'Pengembangan Dana Zakat, Infak, Shadaqah Dan Wakaf Terhadap Pertumbuhan Industri Keuangan Non Bank Syariah' (in Indonesian) ['The Development of Zakat, Infak, Shadaqah, and Waqf Funds in Relation to the Growth of the Non-Bank Islamic Financial Industry'] (2017) 2(2) *Jurnal Masharif al-Syariah* 1, 13.

⁴ Samir Alamad, *Financial and Accounting Principles in Islamic Finance* (New York: Springer International Publishing 2019) 28.

⁵ 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.

⁶ 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.

⁷ 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)' (in Indonesian) ['Ideal Mapping of Zakat and Waqf Fund Distribution Patterns for the Welfare of Mustahik (A Study at Yatim Mandiri Zakat Institution, Surabaya, East Java)'] (2021) 1(1) *Zawa: Management of Zakat and Waqf Journal* 15.

⁸ *ibid.*

⁹ 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.

might be tempted to cheat for personal gain.¹⁰ 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 is crucial for fostering trust and managing fund disbursements in informal agreements.

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 similar to informal banking systems by improving the quality of financial reports.¹¹ Similarly, studies on zakat fund management across three different Muslim countries emphasize the central role of robust reporting systems in enhancing institutional performance.¹²

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.¹³ 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.¹⁴ Although they recognize that the selection and organisation of institutions are not solely driven by economic efficiency, their analysis still focuses on the maximization of zakat institutional funds rather than supervision and regulation.

Although the financial reporting is significant for 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 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.

The subsequent discussion in this article is structured as follows. Part II presents the methodology employed in the study. Part III considers the Islamic financial principles on zakat for economic empowerment. Part IV examines the international zakat core principles. Part V reviews international case studies related to zakat, addressing associated risks and the normative aspects of zakat fund management. Part VI presents the findings and analysis concerning the risks and regulatory frameworks governing zakat fund management. Finally, part VII of this article offers conclusions and recommendations, emphasising how

¹⁰ Avner Greif, 'Contract Enforceability and Economic Institutions in Early Trade: The Maghribi Traders' Coalition' (1993) 1 *The American Economic Review* 525, 527.

¹¹ 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.

¹² 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.

¹³ Jubei Levianto, 'Ketika Komersialisasi Agama dan Penipuan Berjalan Beriringan: Kasus Aksi Cepat Tanggap' (in Indonesian) ['When the Commercialisation of Religion and Fraud Go Hand in Hand: The Case of Aksi Cepat Tanggap'] (2024) 5(2) *Management Studies and Entrepreneurship Journal* 5262, 5262-5266.

¹⁴ Fadilah Sri, Maemunah Mey, Hernawati Nopi, 'Community Social Empowerment in Zakat Community Development (ZCD)' (2019) 35(2) *MIMBAR Jurnal Sosial dan Pembangunan* 460.

incorporating normative frameworks and stringent supervision can enhance transparency and restore public trust.

II. RESEARCH METHODOLOGY

Qualitative descriptive research is employed in this study with the content analysis approach to draw conclusions by identifying the characteristics of messages within the data. This approach is combined with an Islamic economic perspective, normative aspects and social aspects.¹⁵ 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.¹⁶

The research relies on primary data sources, including verbal and behavioural elements, as outlined by Lofland and cited by Lexy J. Moleong, supplemented by additional data.¹⁷ To support the investigation in the practice of the normative and cultural framework of zakat supervision within Indonesian Muslim society in a context of disclosure and transparency of the zakat fund that leads 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 of 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 collecting documentations 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 meetings and telephonic conversations 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 interview responses and written documents. The analysis employs both deductive and inductive methods to assess the data qualitatively. It begins with reviewing all pre-designated data from sources such as interviews and field notes, followed by data reduction through abstraction and detailed organisation. Data categorization and scrutiny ensure accuracy, leading to a final analysis addressing the question of the role played by normative

¹⁵ Kabir Hassan and Aishath Muneza, '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.

¹⁶ Sami Al-Daghistani, *The Making of Islamic Economic Thought: Islamization, Law, and Moral Discourses* (New York, Cambridge University Press 2022) 97-141.

¹⁷ Moleong Lexy, *Metode Penelitian Kualitatif* (in Indonesian) [*Qualitative Research Method*] (Bandung: PT. Remaja Rosdakarya 2001) 40.

cultural practices in Zakat distribution, and the extent to which they integrate with official regulatory demands.

III. ISLAMIC FINANCIAL PRINCIPLES ON ZAKAT FOR ECONOMIC EMPOWERMENT

In Islamic teaching, *al-falah* (success) is not merely the material achievement, but encompassing both worldly success and spiritual prosperity in the afterlife. This concept is against the secular views of success, which is tied solely to material wealth, instead Islam provide a dual framework, where *falah* is the final state of well-being through the adherence to spiritual and ethical values of Islamic teachings.¹⁸ Ibrahim and Chek describes a model of *falah* maximisation approach, they write:

“zakat is the turning point of the receiver to attain *falah* in his life. Complemented with his own good values in adhering to Allah’s rules, he did become successful in the business and becoming *asnaf* entrepreneur which can be a good example on how zakat can help Muslim attain *falah* in this world.”¹⁹

One of the holistic views of *falah* is the obligatory of Zakat for Muslims, that play a role in promoting social equity, enhancing communal harmony and reducing poverty. In fact, Zakat upholds beyond social functions as it serves as spiritual purification by removing selfishness and greed, which is align with the Islamic notion of *falah*. Thus, in Islamic thought *falah* is not solely about individual success but involve the success of the entire community. This study builds on the concept of social responsibility, for economic redistribution, moral and spiritual growth of individuals and society in making Zakat as tool for the success of spiritual and material in Islam. In 2020, the Islamic Research and Training Institute (IRTI) issued The Islamic Social Finance Report (ISFR) which identified four pivotal components of Islamic social finance for economic empowerment: Zakat, *Infaq* (Voluntary Spending), *Sadaqah* (Charity), and *Waqf* (Endowment). Also known in a short form as ZISWAF, these components are essential for integrating Islamic ethical principles into microfinance practices.²⁰

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.²¹ 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.²² In practice, it is mandatory for every Muslim to give 2.5% of their wealth for charity in the form of zakat. Some may argue that this system reduces income, but Muslims firmly believe that this practice brings *barakah* (blessing) to their businesses and alleviates poverty.²³ The term "Zakat" finds its

¹⁸ Aroua Robbana, Abdessamad Raghbi and Abdul Gafar Fahm, “Revisiting Socioeconomic Development Hypothesis: Does Zakat Matter for OIC Member Countries?” (2023) 2(2) Journal of the Knowledge Economy.

¹⁹ Mohd Ibrahim and NorMaslina Chek, ‘The Concept of *Al-Falah* Maximization: Zakat and Industry Revolution 4.0’ (2020) 4(1) Labuan E-Journal of Muamalat and Society 14.

²⁰ 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 14 July 2024.

²¹ Husain Kamil, ‘Contribution of Zakat and Community Economic Welfare’ (2021) 2(1) Indonesian Journal of Social Science Research 39, 39-46.

²² Setiawan (n 5) 222.

²³ 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.

etymological roots in words denoting purity, goodness, blessings, growth, and development.²⁴ In Islamic jurisprudence, Zakat signifies not only the purification and growth of wealth but also its blessings and enhancement.²⁵ This concept implies that wealth subjected to Zakat will increase in purity and blessings, ultimately benefiting its possessor.²⁶ Technically, Zakat refers to the obligatory portion of wealth that a *muzakki* is required to distribute to eligible recipients as mandated by Sharia law.²⁷ *Mustahik* denotes individuals entitled to receive Zakat, specifically described as the eight categories found in the Qur'an, Surah At-Tawbah, verse 60.²⁸

Zakat represents not merely a revenue tax but fundamentally a levy on wealth. Its essential role resides in the equitable redistribution of resources, specifically addressing poverty within marginalized sectors of society.²⁹ Consequently, it carries substantial moral implications, intertwining with principles of social justice and envisioned solidarity among diverse socio-economic strata.³⁰ Zakat acts as a mechanism to encourage the active use of wealth, discouraging hoarding and promoting its circulation within the economy.³¹ 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.³²

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.³³

These principles were built upon Basel Core Principles (BCPs) but are adapted to suit the various contexts of zakat supervision. The BCPs primarily address financial reporting and institutional governance within the zakat management domain, but there are some principles less relevant,³⁴ for instance, principles related to consolidated supervision and home-host relationships. There are, however, several principles that are directly adapted: these 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.³⁵

²⁴ Yusuf Qardhawi, *Fiqhus Zakat* (Beirut: Muassasah Risalah 1991) 10-27.

²⁵ Wahbah Zuhaili, *Al-Fiqh al-Islami wa Adillatuhu* (Beirut: Dar Al-Fikr al-Mu'as 1999) 83.

²⁶ *ibid.*

²⁷ Qardhawi (n 24) 35.

²⁸ Qur'an, Surat At-Tawbah (The Repentance) 9:60.

²⁹ Qardhawi (n 24) 41.

³⁰ Setiawan and Suwandar (n 23) 8.

³¹ Zuhaili (n 25) 80.

³² Roger Garaudy, *Mencari Agama pada Abad XX: Wasiat Filsafat Roger Garaudy* (in Indonesian) [*Seeking Religion in the 20th Century: The Philosophical Legacy of Roger Garaudy*] (Jakarta: Bulan Bintang 1986), 95.

³³ International Working Group on Zakat Core Principles (n 9) 1-17.

³⁴ *ibid.*

³⁵ *ibid.*

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 <i>Muzakki</i> 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)

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 represent the 18 Zakat Core Principles, which involve aligning the institution's mission with long-term goals while preventing reputational damage. Indeed, together, these principles are formed to build a comprehensive approach to managing the diverse risks inherent in zakat administration.³⁶ However, the system of zakat core principles fails to include social behaviour as one of its core principles. In Islamic social behaviour, every Muslim can be expected to be a volunteer in disseminating kindness for the zakat fund. If the recipient of zakat acts deceitfully 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.³⁷ 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:

³⁶ *ibid.*

³⁷ 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.

“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.”³⁸

It is a common problem where 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.³⁹ 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.⁴⁰ This informal oversight is crucial for maintaining trust and adherence to Sharia principles.

V. ZAKAT CASE STUDIES – ISSUES AND RISKS

Prominent Muslim scholars emphasise that effective zakat management relies on transparent financial reports and a focus on building strong institutions that are responsible of collecting and distributing Zakat.⁴¹ While it is considered as an essential aspect of Islamic financial systems, zakat management faces various issues 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 management. These examples describe the necessity 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, IRTI 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)

³⁸ *ibid* 24.

³⁹ Greif (n 10) 528.

⁴⁰ Alamad, (n 4) 28.

⁴¹ International Working Group on Zakat Core Principles (n 9) 1-17.

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.⁴²

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 et 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.”⁴³

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.⁴⁴ This regulatory ambiguity enables zakat institutions to collect funds with insufficient oversight regarding their allocation, thereby increasing the risk of mismanagement.⁴⁵

For example, the Islamic Financial Institutions in Indonesia often channelled their zakat fund to third institutional parties (such as Baitul Maal Institutions) instead of paying it directly, for instance Baitul Maal Hidayatullah (BMH) acted as a third party for 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.⁴⁶ Hakim et al connotes “The lack of standard on how supervision is carried out makes supervision become not objective, effective and efficient. Thus, the precise standard of Sharia Governance System for ZMO is required”.⁴⁷

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 organisations 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

⁴² *ibid.*

⁴³ 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.

⁴⁴ *ibid* 123.

⁴⁵ *ibid.*

⁴⁶ Setiawan (n 5) 222.

⁴⁷ Cecep Hakim, Ascarya, Irfan Beik, Sigid Pramono and Abdul Saoqi, ‘Designing Shariah Governance Standard for Zakat Management Organization: Indonesia Experience’ *Badan Amil Zakat Nasional* (Jakarta: February 2019) 6 <<https://www.iconzbaznas.com/publications/index.php/pwps/article/view/97/70>> accessed 5 October 2024.

lack of bias, all of which would be essential to prevent Z4D programs from turning into sinkholes of corruption.”⁴⁸

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.⁴⁹ ACT, one of Indonesia’s largest philanthropic organisations, had built a strong reputation through its extensive social and humanitarian programs. Despite this, the organisation faced a significant crisis in 2022 when investigations revealed severe weaknesses in its zakat and philanthropic management.⁵⁰ 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 organisation’s mission. This misuse of funds highlighted critical failures in maintaining the integrity and trust of donors.⁵¹

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.⁵² 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.⁵³ 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 management. This added a dimension of abuse, undermining public trust and exposing serious conflicts of interest.⁵⁴

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.⁵⁵ Additionally, stringent government regulations are necessary to ensure accountability and proper allocation of zakat funds. Educating the public about the importance of 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.⁵⁶

B. Case Study: Best Practices in Zakat Management

The robust risk management practices are 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

⁴⁸ 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.

⁴⁹ Levianto (n 13) 5262.

⁵⁰ *ibid.*

⁵¹ Indah Rosalina and Nabilah Nurlaely, ‘Penyelewengan Dana Donasi ACT dalam Bingkai Kompas TV’ (in Indonesian) [‘Misappropriation of ACT Donation Funds as Framed by Kompas TV.’] (2023) 2(1) Daruna: Journal of Communication 13.

⁵² Levianto (n 13) 5262.

⁵³ Rosalina and Nurlaely (n 51) 18.

⁵⁴ *ibid.*

⁵⁵ Levianto (n 13) 5265

⁵⁶ *ibid.*

and ensure compliance with Sharia principles and high accountability standards.⁵⁷ 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”.⁵⁸

Zakat distribution should adhere to 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 accountability standards. For example, LZNK adheres to specific guidelines for auditing and reporting, as evidenced by the documented procedures provided by the institution.⁵⁹ 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.⁶⁰ 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.⁶¹ 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 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)

⁵⁷ 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.

⁵⁸ Mohamad Muhaimin Mohamad Zaki, Jasni Sulong and Hafizah Zainal, ‘Penentuan Skim Agihan Zakat Pendidikan Kajian di Lembaga Zakat Negeri Kedah (LZNK)’ (in Malay) [‘Determination of the Educational Zakat Distribution Scheme: A Study at the Kedah State Zakat Board (LZNK)’] (2021) 1(2) *Azka International Journal of Zakat Social Finance* 123, 124.

⁵⁹ Nur Zainie, Rosman Hasyimah and Ibrahim Shamsinar, ‘Mekanisma pemantauan: memperkukuhkan pengurusan agihan zakat wakalah oleh lembaga zakat negeri Kedah (LZNK)’ (in Malay) [‘Monitoring Mechanism: Strengthening the Management of Waqf Zakat Distribution by the Kedah State Zakat Board (LZNK)’] (2022) 4(1) *International Journal of Business Economy* 177, 177-179.

⁶⁰ Zaki, Sulong and Zainal (n 58) 123.

⁶¹ *ibid.*

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.⁶²

LZNK also excels in economic empowerment initiatives, focusing on improving the welfare of impoverished communities through various programs funded by zakat. As the LZNK's staff indicates that "it is our institution vision to be innovative by focusing on long-term economic empowerment instead of just giving one-time assistance".⁶³ Rather than relying on the traditional 'one-off' assistance, the LZNK programs focus on 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.⁶⁴

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 organisations, demonstrating that adherence to Sharia principles and high accountability standards can lead to significant societal benefits and public trust.⁶⁵

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.

V. 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".⁶⁶ The absence of strong regulations creates opportunities for some institutions to misuse zakat funds.

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 is considered less effective, since it is done without sufficient oversight from the financial institutions themselves.⁶⁷ Sometimes, zakat funds are used for

⁶² *ibid.*

⁶³ Interview with the representative of LZNK, 14 July 2024.

⁶⁴ *ibid.*

⁶⁵ Zainie, Hasyimah and Shamsinar (n 59) 177.

⁶⁶ Mukhlisin et al (n 43) 130.

⁶⁷ Dikuraisyin and Dayanti (n 7) 15.

institutional promotion or even political interests, undermining public trust.⁶⁸ 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 manages the zakat funds through dedicated zakat account, this practice can minimise issues caused by a lack of oversight by financial authorities.⁶⁹ 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).⁷⁰ 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.⁷¹

Indeed, an empirical case from the Islamic Bank of Thailand can help to partially 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, implementing stricter regulations, improving supervision, and increasing transparency could significantly enhance zakat management.⁷²

However, strict regulation alone is not enough; there must also be thoughtful supervision that continually upholds structural normativity. Zakat supervision frequently involves 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 moral and ethical behaviour has been embedded historically and culturally in Islamic society itself.⁷³

VI. 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.⁷⁴

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

⁶⁸ Khan and Qutub (n 37).

⁶⁹ 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 23 July 2024.

⁷⁰ 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.

⁷¹ *ibid.*

⁷² Hassan and Muneeza (n 15) 217.

⁷³ Ercanbrack (n 6) 21.

⁷⁴ Alamad (n 4) 28.

framework in IFI".⁷⁵ 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.⁷⁶

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, being responsive to public feedback and criticism are crucial steps in maintaining a positive reputation.⁷⁷

Consequently, the distribution of zakat funds should adhere to sharia principles so as to ensure sharia-compliance. Zakat institutions should follow the Sharia given guidance and respect the divine morals and ethical behaviours, this would also ensure that zakat fund is managed with thorough risk assessments and in accordance with established policies. Regular evaluations should be conducted to ensure that zakat funds are directed towards productive and essential purposes with the object of minimizing the risk of financial losses.⁷⁸

VII. CONCLUDING REMARKS

Sometimes, the profit-oriented materialistic perspectives can dominate the normative approaches. Islam encourages an 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 literature in the field of zakat management, there are 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

⁷⁵ *ibid* 265.

⁷⁶ Wahyudi (n 11) 122.

⁷⁷ *ibid*.

⁷⁸ Bremer (n 48) 55.

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 analysing 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 funds by the financial authorities, and improved transparency where every individual's eye is acting as an intermediary 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 exploring and refining these approaches, ensuring that zakat management evolves to meet material and spiritual objectives in an increasingly complex global context.