

ZAKAT

and
POVERTY ALLEVIATION



Edited by
MOHD MAHYUDI MOHD YUSOP • NAZIRUDDIN ABDULLAH



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Chapter 4

Financial Control Practices of *Zakat* Institutions in Malaysia

Muhammad Akhyar Adnan
Bashir Abdisamad Hareed

Introduction

In the last two decades, financial scandals and mismanagement of religious organisations resources have plagued the western world. Complaints from the churches have increased and the reputation of the religious centers has been tarnished (Edwards, 1990). These developments have raised concerns about the financial control management of religious organisations as well as attracted the attention of researchers to conduct studies on the Western religious organisations (Wooten, Coker and Elmore, 2003).

In the case of Islamic religious organisations, much is not known about their financial performance. Even though, there have not been any reports of financial scandals in Islamic religious organisations, there has been an increasing concern on whether these organisations are experiencing similar deficiencies as other religious institutions in the West (Maliah Sulaiman, 2007). Although there are quite a number of studies on Islamic religious organisations, they have mainly emphasised the general administration and performance measurement such as *waqf* and *zakat* institutions (for example; Bakar, 1998; and Abdul Rahim and Goddard, 1998).

In Malaysia, the *zakat* institution is a division of the State Islamic Religious Council (SIRC), and it is described as a societal institution that is perceived as publicly-owned. It is established to handle and manage *zakat* funds including collection and disbursement (Bakar, 1998). It falls

under the SIRC, which is assigned to administer all religious affairs. In spite of the importance of *zakat* in Muslim society, there are very few studies about *zakat* administration. For instance, Osman and A. Hamid, (n.d.), Jamaliah, (2004), and Nazifah Mustapha (2007) commented on the inefficiency of the management system and performance level of *zakat* institutions in Malaysia. This has been attributed to the shortage of experts.

Even though the available literature on *zakat* institutions has not given such considerations to the area of financial control of these institutions, the current available literature shows that *zakat* institutions do not display sound financial management practices (Mohamed Dahan, 1998 and Osman and A. Hamid, n.d.). This can create dissatisfaction among the society with regard to *zakat* institutions' ability to meet the religious and social needs of the Muslim community (Osman and A. Hamid, n.d.).

However, the majority of the literatures, whether on western or Islamic religious organisations, show poor general administration of funds, inadequacy of sound financial practice, lack of accountability, inappropriateness of accounting systems and poor financial control, and finally, insufficient financial disclosure and reporting. This has motivated the researchers to explore the financial control practices of *zakat* institutions in Malaysia with special focus on the four financial control procedures of: a) Control over environment, b) Control over receipts, c) Control over disbursements, and d) Financial reporting.

It is expected that a thorough analysis of the results will provide a better understanding of the state of financial control practices of *zakat* institutions. It is hoped that the findings of the study will serve as a model for *zakat* institutions in the Muslim world.

Financial Management in Nonprofit Religious Organisations

Religious institutions have the same nature and characteristics as other non-profit organisations (NPOs). The core objective of NPOs is to be service oriented, by maximizing the quantity or quality of the services provided to a given type of customers (Baraldi, 1998). The tasks of

NPOs include promotion of educational attainment, charitable, health and social welfare activities to society at large (Anthony and Young, 1999). Apart from the aforesaid characteristics, religious NPOs strive to improve the religious and spiritual well-being of the society (Haller, 1982). In addition, one of the significant characteristics of NPOs is that it heavily depends on volunteer management and support from people who are interested in the mission of the organisation. This may not motivate these organisations to employ professionals and experts who may demand a higher remuneration which the organisation is unable to offer due to insufficient financial resources.

Generally, financial management of business organisations involves planning the ways to obtain resources and to use them effectively. This is to the fullest interest of the organisations (Miller, 1994), but financial management for NPOs, including religious institutions, is more concerned about the well-being of the society rather than profit maximization. Thus, the strategy of financial resources in NPOs is the techniques that can improve its fundraising mechanisms and the proper applications of the funds. As Miller (1994); and Barata and Cain (2001) observe, the financial management of NPOs is the process wherein the organisation, (1) employs the means to obtain and allocate resources and/or money, based on implied or articulated priorities, (2) utilises methods and control that will ensure the full achievement of its objective by serving the public effectively.

The success of NPOs is mainly measured by its contribution to the public. It strives for the benefit of the society. Therefore, the management of the financial resources of these institutions is a very challenging one, which demands a higher accountability to effectively manage the available limited public resources. Herzlinger and Nitterhouse (1994) declare that financial management and control of NPOs entail an extraordinary demand to maintain financial and organisational stability and growth for the sake of social welfare.

On the other hand, Duncan, Flesher and Stocks (1999) perceived that the absence of stock ownership, in NPOs, makes the management control of such organisations more complex than profit seeking organisations. Thus, Duncan, Flesher and Stocks (1999) observed that fiduciary responsibility is the highest standard of care applicable to the governing board of NPOs that would be accountable to the public

at large. The concept of fiduciary responsibility implies that financial control and effective management of resources are the crucial areas of nonprofit governance. This means that management of NPOs must be extremely loyal to the public to whom they owe the responsibility. They must not profit from their position as a fiduciary, unless with the principal's consent. The fiduciary relationship is highlighted by good faith, loyalty and trust.

Accountability: Western Versus Islamic View

Although the term accountability has been described differently by different authors, in its simplest form, Gray et al. (1996) define it as:

The duty to provide an account (by no means necessarily a financial account) or reckoning of those actions for which one is held responsible.

Portraying accountability relationship, in a theoretical insight, Laughlin (1990) and Gray, Owen and Adams (1996) illustrate an accountability model which presumes the existence of at least two parties, one who allocates responsibility and another who accepts it with the undertaking to report on, and account for, the manner in which it has been discharged in this model, the principal (assignor) gives power over the resources along with the instructions about the actions and rewards of the agent.

On the other hand, the person assigned with the responsibility is expected to take certain actions and refrain from others in order to manage the resources and maintain the trusts the assignor has in him, in a manner that would meet the principal's objectives and desires, by giving him enough information about the decisions taken by the assignee (agent) (Shahul, 2000). According to Gray, Owen and Adams (1996) the contract between the principal and the agent can be categorised as legal contract, which is established and governed by law, or moral (natural) contract, which is governed by ethical rules, values and the principles of the society.

The two-sided accountability relationship presented by Gray, Owen and Adams (1996) has been criticised for not being morally inclined but only emphasizing the material aspect of accountability, which

implies that the resource owner should be aware and reflective about the responsibilities towards the stakeholders of any action or inaction. On the contrary, there is also another problem that is, who determines which action the user of resources must execute will be accountable for it. Also an inquisitive mind would like to know the extent of the responsibilities of the assignor. To overcome the shortcomings of the above form of conventional accountability relationship, the suggestion, developed by Shahul (2000), might be a worthy of consideration.

As an alternative definition for a broader and morally inclusive accountability, Shahul (2000) has extended the current conventional form of accountability and argued that accountability is:

the duty of an entity to use (and prevent the misuse of) the resources entrusted in an effective, efficient, and economical manner, within the boundaries of the moral and legal framework of the society, and to provide an account of its actions to accountees who are not only the person who provide it with its financial resources, but to groups, within society and to society at large.

Although this definition is quite long, it encompasses all aspects of governance and operations of different types of institutions, be it public or private.

According to this definition, and with the contemporary understanding model, accountability represents an agreement which authorises the carrying out of an activity, where the agent will be responsible for any action taken or refrained by him; and accountable to anyone whom is influenced by that action or inaction, directly or indirectly. Eriksen (2002) asserts that accountability would be a quality or state of an object, necessitating an outside voice to do the actual accounting.

Due to the differences in the ideological and philosophical concepts and values between western and Muslim societies, the meaning and practice of accountability should be different. Since the values and norms of the world differ from society to society, problems that usually arise are who determines or defines whether the actions undertaken by the agent, individual or organisation, is right or wrong, or whether the policies applied by the agent conforms to the interests of the public as a whole or of only the principal.

In the Holy Qur'an, the word *hisbah* is used frequently in many verses (Lewis, 2006). The word *hisbah* means an account, which is the root word for accountability to demonstrate one's sense of responsibility to Allah SWT in all matters pertaining to the worldly life and the hereafter. It is stated in the *Qur'an* (Al-Isrā: 36), that Allah SWT will question the hearing, sight and heart of every person of any action or statement performed through those organs. This means that man is responsible for and accountable for those responsibilities before Allah SWT and to the other creatures as well. *Hisbah* denotes that humankind is an agent who has to bear the responsibilities as *khalifah*. Allah SWT has made all the resources available for human beings and entrusted these resources upon them, and they shall be judged on whether or not they have performed according to the guidelines of Allah SWT. Their success in the hereafter depends on their performance in this world. Thus, the instructions of the Qur'an and the teaching of the Prophet SAW represent the foundation of Muslim values and norms of wealth management and financial accountability of Muslim individuals. This is what makes Muslim values and norms different from the Western values and norms, which in turn affects the social and economic behaviour of different societies.

Shahul (2000) raises the problems of the conventional and secular definitions of accountability, which does not consider the implications of the various societal values which describe the contractual responsibilities of both principal and the agent. Therefore, the definition given by Shahul (2000) seems to be comprehensive and inclusive giving a wider picture about how the principal-agent contract works in the Islamic system.

Shahul (2000) affirms that since values and norms of Muslim societies are derived from their divine revelation, the contents and connotations of accountability should be in line with the objectives of Islamic *shariah*. The interpretation of accountability, in the perception of Muslim *ummah*, would be different from the western interpretations, which is derived from man-made philosophies.

The values and working norms, which are derived from the original sources of revelation and affirmed by the Muslim intellectuals and intuitive principles (Al-Attas, 1995), reveals that man, in Islam, is a vicegerent on earth and servant of Allah SWT. The vicegerent is duty bound in this world, to properly utilise the resources entrusted to

him (Haneef, 1997). While the role of the servant implies the nature of responsibility, which denotes that, as a servant, man is not independent and has no absolute authority other than to obey the instructions of Allah SWT. In that sense, man is *mukallaf* (accountable to Allah). This implies that everyone is accountable for his actions or inactions on the Day of Judgment (Al-Safi, 1992).

As illustrated by Shahul (2000), Islamic accountability is based on a dual responsibility. This concept of dual-accountability similarly applies to the *zakat* institution, where the management is accountable to Allah SWT that they are, on one hand, managing *zakat* funds as Allah SWT ordained in the Qur'an and described by the Prophet SAW, and, on the other, properly providing the *zakat* funds to the right beneficiaries as instructed in the Qur'an (Nazifah Mustapha, 2007). This dual-accountability also obligates *zakat* management to be in a contractual agreement with *zakat* payers who want to ensure that the *zakat* institution has employed financial accountability mechanisms. Similarly, based on the *Hisbah* concept, a Muslim should have a high degree of social responsibility (Abdul Rahim, 1998).

It is of paramount importance for *zakat* institutions to be accountable for all financial and non-financial matters that affect both *zakat* payers and recipients. The implementation of timely and accurate financial accountability plans will help strengthen the ties between *zakat* management and the stakeholders (*zakat* payers and beneficiaries), and increase in other *sadaqah* (charity) contributions. In addition, such a move will encourage the rich Muslims to fulfil their obligations towards Allah SWT and to the community at large. Therefore, sound internal financial control and disclosure of the *zakat* institutions' financial activities is in tandem with Islamic accountability upon the resources entrusted to the management of the institution.

Administration of *Zakat* Institutions in Malaysia

Although Islam is the official religion of Malaysia, the federal government does not have the authority to interfere in religious matters directly

(Osman and A. Hamid, n.d.) since all religious affairs, including *zakat*, are run by the SIRC of every state. The SIRC handles all matters related to religious affairs in Malaysia. However, the administration system of the *zakat* institution varies from one state to another (Jamaliah Abd Majid, 2004). In some states, the *zakat* institution falls under the SIRC while in others it falls under the Islamic Department (Nik Mustapha, 1991; Bakar, 1998).

In the following section, the study discusses the system of *zakat* collection and distribution as being practiced by the *zakat* institutions in Malaysia.

Administration of *Zakat* Collection

As far as *zakat* management is concerned, the collection task is the most important duty because disbursement depends on what is collected. During the early days of Islam, the Prophet (pbuh) ordered Mu'adz bin Jabal r.a. to collect *zakat* from the rich and distribute it among the needy and destitute. *Zakat* collection and fair distribution among its beneficiaries were the concern of the Prophet (pbuh) during his lifetime.

Although the *zakat* institution is considered a religious body, naturally it has an economical and a communal character, since its collection is the responsibility of the state or government because the Prophet (pbuh) himself used to appoint *zakat* collectors (Bakar, 1998) and sometimes involved himself (pbuh) directly in distributing it to the poor.

In Malaysia, the religious body that administers *zakat* collection and disbursement differs from one state to another. For instance, in Melaka, the administration of *zakat* affairs is handled by a board known as *Lembaga Urusan Wakaf, Zakat dan Baitulmal* (LUKMAL); while in the Federal Territories, *zakat* is handled by the government officers through the Islamic Department or *Jabatan Agama Islam Wilayah Persekutuan* (JAWI) (Bakar, 1998; and Nazifah Mustapha, 2007).

Zakat Collection Mechanisms

These are mechanisms employed to collect *zakat* efficiently, and the *zakat* collection system in Malaysia is much better compared to the other Muslim countries (Osman and A.Hamid, n.d.). One of the innovative methods of *zakat* collection is that, in some states, *zakat* collection has been corporatised by setting up a separate body that administers all matters pertaining to the administration of *zakat* collection (Mohamed Dahan, 1998). To enhance the efficiency of the *zakat* collection system, the SIRC in Wilayah Persekutuan (Federal Territory) took the initiative to corporatise and established the first *zakat* collection centre known as the *Pusat Pungutan Zakat* (PPZ) in 1991 (Nazifah Mustapha, 2007). This has improved the effectiveness of the administration of *zakat* institution in Wilayah Persekutuan (Mohamed Dahan, 1998). The establishment of the corporatised collection centre or PPZ in Wilayah Persekutuan was followed by some other SIRCs; for example, Selangor (1994), Pulau Pinang (1994), Pahang (1996), Melaka (1996), and Negeri Sembilan (1998), (Saad, 2000, Mahmud, 2001, cited by Nazifah Mustapha, 2007). This move was intended to improve the collection of *zakat* and to develop ways *zakat* payers can easily fulfil their financial obligations. On the other hand, the responsibility of the collection centres in the states of Selangor and Pulau Pinang have been extended to include distribution tasks, where the centers have authority over both collection and distribution (Nazifah Mustapha, 2007).

As mentioned earlier, the concept of corporatisation of *zakat* institutions is to enhance the efficiency of the collection system. Nor Ghani et al. (2001) assert that after the corporatisation of collection, there has been an increase in collection in the majority of states. Although the study pointed out that the increase in collection may be attributable to other factors, corporatisation is the major factor that affected collection significantly.

Other Instruments Developed for Effective *Zakat* Collection

Additionally, *zakat* institutions have developed other instruments for handling both *zakat* collection and disbursement. Apart from the

corporatisation and collection by workers or amil assigned by the *zakat* offices, there are several other supporting bodies which are given the authority to collect funds from the payers and transfer it to the accounts of *zakat* institutions. Such bodies include the Income Tax Department (through deductions from salaries), *Baitulmal* subsidiaries, higher learning institutions (such as universities), collection counters in the banks, post offices, and shopping centers. This has played an important role in facilitating collection procedures and simplified the payments of financial obligation (Osman and A. Hamid, n.d.).

On top of this, collection centres have put in place facilities that would simplify *zakat* payers' transaction; thus, saving their precious time and effort. Such facilities include computerised collection systems, proactive marketing approaches (Osman and A. Hamid, n.d.), and payments via commercial banks and e-banking systems. These facilities play an essential role to shorten the processing time of *zakat* payers and hence, enhance *zakat* payments. Because of the development of mechanisms and administration system, there has been a remarkable improvement in the collection of *zakat* funds. For example, Osman and A. Hamid (n.d.) note that in 1991, the *zakat* funds collected was only RM61 million, but this amount rose to RM258.7 million in 2000, RM473 million in 2004, and RM573 million in 2005 respectively.

Administration of *Zakat* Disbursement

The main purpose of *zakat* is the reduction of poverty and hardship among Muslims through wealth redistribution. The distribution of *zakat* proceeds and its beneficiaries are clearly specified in the Qur'an (Al-Tawbah: 60); this task is not left to human judgment (Kahf, 1990). The categories that deserve *zakat* proceeds are only those defined in this verse in which Allah (SWT) instructs (meaning):

Alms are for the poor and needy and those employed to administer the *zakat* funds; for those whose hearts have been (recently) reconciled (to the truth); for those in bondage and indebted; in the cause of Allah; and for the wayfarer: (thus is it) ordained by Allah and Allah is full of knowledge and wisdom (Al-Tawbah: 60).

These beneficiaries have the right to receive *zakat* proceeds in an equal portion of the total *zakat* collected. Regarding the issue of the timing of distribution, however, Islamic scholars disagree on whether *zakat* proceeds ought to be paid immediately or not. As Al-Qardawi (1999) states, the Hanafi point of view is the immediate payment of *zakat* proceeds; otherwise, *zakat* loses its objectives to help the poor and needy. But as various studies reveal, some religious institutions do not consider immediate disbursement of *zakat* funds as necessary, and this will be discussed later in this section.

Models of *Zakat* Disbursement

According to Kahf (1990) there are two models of *zakat* disbursement; (i) disbursement through the state public budget, and (ii) disbursement through specialised *zakat* organisations.

Disbursement of *Zakat* Through the State Public Budget

In this approach the disbursement is based on the budgeted items with emphasis on the beneficiaries' needs. The government specifies the actual *zakat* proceeds and the expenditures used for the collection, assigns an institution to undertake *zakat* disbursement in accordance with the Islamic *shariah* and administrative principles. This approach has been implemented in Saudi Arabia and Yemen (Kahf, 1990).

Disbursement of *Zakat* Through *Zakat* Institutions

In the second approach, *zakat* collections are not included in the state public budget. Therefore, disbursement is managed separately through specific institution, i.e., the *zakat* institution (Kahf, 1990). This approach is practiced in Malaysia, Pakistan and Sudan. *Zakat* institutions may disburse the proceeds (i) directly disbursement by the *zakat* institution itself, (ii) through local committees, (iii) through governmental authorities, or (iv) through intermediary institutions (Kahf, 1990).

Further to the above, *zakat* can be disbursed through direct or indirect means (Kahf, 1990). Direct distribution refers to the disbursement of *zakat* funds to the beneficiaries in terms of cash, cheque or material (Nazifah Mustapha, 2007), whilst in indirect distribution, *zakat* funds are disbursed to recipients through projects or programmes which can provide long term benefits to them.

In Malaysia, the disbursement in some states is through the same *zakat* institution that makes the collections; while in other states, collection is corporatised and managed by privatised organisations (Nazifah Mustapha, 2007). For example, in Wilayah Persekutuan, *Pusat Pungutan Zakat* (*Zakat* Collection Centre) is only responsible for the collection, while disbursement is assigned to *Baitulmal Wilayah* which is a public institution (Mohamed Dahan, 1998, as cited in Nazifah Mustapha, 2007). Similarly, *zakat* disbursement is corporatised in the states of Pahang, Selangor, Pulau Pinang, Negeri Sembilan and Melaka. Although there are still some shortcomings in the disbursement of *zakat* proceeds in some states as Nazifah Mustapha (2007) pointed out, disbursements have improved generally after corporatisation of disbursement by *zakat* institutions. However, not all *zakat* proceeds are disbursed at times.

Retention of *Zakat* Proceeds

This implies that not all funds generated through *zakat* are disbursed; a certain percentage is disbursed while the remaining proceeds are kept aside.

In a study about *zakat* performance in Malaysia, Nazifah Mustapha (2007) showed that some *zakat* institutions retain *zakat* proceeds and do not distribute them at the appropriate time. For example, in Kedah around 31% to 43% of the *zakat* funds were retained from the year 1994 to 1996. In the state of Pahang only 71% and 68% of the *zakat* funds collected in the years 1998 and 1999 respectively were distributed (Nazifah Mustapha, 2007). Osman and A. Hamid's (n.d.) findings also indicate that only 60% to 80% of *zakat* funds collected is usually disbursed, while the balance is deposited to the *zakat* saving funds for future use.

Financial Control and Accounting Practices

There are very few studies in the area of accounting and financial management in *zakat* institutions. In fact a very unique study, though dated, was carried out by Khan (1990) who compared and evaluated *shariat*, administrative and financial controls of *zakat* systems in Pakistan and Kuwait. Khan (1990) justified his selection of these two countries on the premise of their similarities in *zakat* practices which allowed them to learn from each other. In the area of financial control, Khan (1990) reports that regulations regarding *zakat* funds custody, accounting, auditing, and precautions against errors, omissions, frauds and misappropriations are fairly similar in the two systems. In his conclusion, Khan (1990) states that there was no control on the idle funds, and although in the financial regulations the audit report was compulsory, at that time no single audit report was prepared by the *zakat* system in Pakistan. However, in Kuwait, the situation was fairly encouraging, and the financial control over resources was rather satisfactory.

In Malaysia, a study conducted by Abdul Rahim and Goddard (2003) on accounting practices in the religious organisations in Malaysia, including *zakat*; found that besides the usage of financial regulations and performance measurements, financial control is exercised through budgeting practices. According to them, SIRC's use accounting and reporting processes for better decision making. But they commented that even though the SIRC's implement budgeting for planning, it was characterised by routine practices. The study covered only two state religious organisations. Assessing the financial reporting system, the authors found that one of the religious organisations (due to confidentiality requirement; this organisation is referred to as A) had not produced financial reports regularly, hence no up-to-date sound financial record was found. On the other hand, the other state organisation (due to confidentiality requirement; this organisation is referred to as B) had limited organised financial information, but produced financial statements regularly.

With regards to accounting practices, the authors found that accounting was marginalised and had extremely limited functions. Thus,

accounting practices were considered as a mere recording tool to keep financial transactions.

In organisation A, the role of the accountant was not important and he had no involvement with the decision-making procedures. In the B organisation, the accountant seemed to be more important, but still had limited influence in the decision-making procedures. In their discussion, Abdul Rahim and Goddard (2003) point out that accounting is not considered as a secular instrument, but seemed to be a supporting tool and technique for performing core religious organisational activities.

In assessing whether the concept of sacred-secular divide exists in the Islamic religious organisations in Malaysia, Abdul Rahim and Goddard (1998) disagree with the assumption and assert that accounting is perceived as an important tool for the Islamic religious organisations. This is contrary to the general findings on Western religious organisations which consider accounting as an irrelevant secular value.

Generally, the literature on the administration of *zakat* institutions in Malaysia indicates that there are some improvements in the management of *zakat* collection and disbursement. Unfortunately, there is not enough information about the financial control and accounting practices in the Malaysian *zakat* institutions.

To the knowledge of the researchers, there are no studies on the financial management practices of *zakat* institutions, in terms of financial control procedures, accounting techniques and financial reporting implemented by the *zakat* institutions, either in Malaysia or in the other Muslim countries, except for a very old study by Akram Khan (1990) on the *shariah*, administrative and financial control of *zakat* systems in Pakistan and Kuwait as mentioned earlier. Since there is no financial control model for Islamic religious institutions, the study adopts a framework developed by Wooten, Coker & Elmore (2003) as a model to explore the status of financial control practices of Islamic religious institutions. This financial control framework is called the matrix of control goals and financial duties. This framework comprises five control procedures; control environment, control over receipts, control over disbursements, and control of financial reports. The framework is considered as a good benchmark that can be used to assess the

financial control practices of *zakat* institutions in Malaysia. There was a slight modification to the model so as to make it appropriate for *zakat* institutions.

Research Method

This exploratory study aims to identify the relevant concepts about a phenomenon and to understand what is going on in a certain situation (Lightbody, 2000; Sekaran, 2003). An exploratory study is usually conducted to better comprehend the nature of a problem since very few studies have been conducted in that area. Similarly, much is not known about the situation of financial control practices of *zakat* institutions in Malaysia. Therefore, this is an exploratory study which explores the status of financial control procedures over financial resources in *zakat* institutions in Malaysia. As described by Sekaran (2003), there are various methods of data collection. It includes face-to-face interviews, telephone interviews and interviews through electronic media; questionnaires that are either personally administered, sent through email, or electronically administered; observations of individuals and other techniques. Sekaran (2003) argues that although interviewing is more flexible in terms of changing, adopting and adapting the questions, questionnaires have the advantage of obtaining data more efficiently in terms of the researcher's limited time, energy and cost. This study utilises questionnaire considering the benefits as stated by Sekaran (2003).

The four control procedures the research question emphasises on are: (a) control environment, (b) control over collection, (c) control over disbursement, and (d) financial reporting of *zakat* institutions. To answer the first part of the research question, which is the existence of control environment procedures, the questionnaire listed 15 YES-NO questions. Similarly, since some of the financial control activities may frequently, but not continuously, be practiced by the institutions, a 18 point-scale questions and eight (8) multiple choice questions were developed to answer the questions about financial control procedures over receipts, disbursements and financial reporting. There were YES-NO, point-scale and multiple choice questions in every control procedure, except the

control environment part. Thus, in one section, e.g., control over receipts, YES-NO, point-scale and multiple choice questions were used.

The target group of the study consists of the top management and finance staff of the *zakat* institutions. For the survey of management and finance staff, fourteen *zakat* institutions including the directors of each institution, deputy directors, deputy directors of collection and/or disbursement (applicable to the corporatised *zakat* institution), finance officers or treasurers (some institutions have treasurers and not finance officers), internal auditors, and accountants. The reason for selecting this sample is that: (1) as *zakat* institutions in Malaysia have branches in the majority of districts in each state, it consumes a lot of time and effort to survey all those branches, (2) the researchers assumed that since the headquarters of each institution represents the decision-making center and all reports are provided and forwarded to them from various branches, then all the relevant data may be obtained from the headquarters records, and (3) since the staff in the headquarters would have better knowledge of the financial information pertaining to *zakat* management, it was decided that data obtained from the headquarters will be enough to analyze the status of *zakat* institutions' practices of certain financial control procedures.

Seventy-three questionnaire sets were posted to the respondents in the 14 *zakat* institutions in SIRCs in the 14 Malaysian states. A cover letter signed by the supervisor and the Head of Accounting Department and a self-addressed and stamped envelope were enclosed to ensure respondents feedback. With the hope that the response rate would be high, one month was allocated for the respondents to mail their feedback. The researchers called the respondents at least three times to remind them before the expected return date.

Out of the 73 questionnaire sets sent out, 41 were returned from 10 *zakat* institutions, which represent a response rate of 56.2% of the respondents and 71.4% of the institutions. Since the returned questionnaires were from more than half the respondents and the majority of the *zakat* institutions, the response rate was considered reasonable. The returned questionnaires were from the states of Kuala Lumpur, Selangor, Terengganu, Kedah, Negeri Sembilan, Perak, Pahang, Penang, Sarawak and Sabah. Several attempts have been made to call and remind

respondents of the remaining four *zakat* institutions but no response was received.

To analyse the results, the researchers used the frequency of the respondents' answers in the financial control procedures by each institution and then calculated the percentage of the practices of certain procedures to compare with those who did not practice them. SPSS software, version 12.0 was used to tabulate the results. In addition, the demographic information of the respondents was also analysed through descriptive statistics.

Research Findings

As discussed earlier, four control procedures were covered by the research question. These were control environment, control over receipts, control over disbursement and financial reporting. Control environment practices explored whether *zakat* institutions implement five written control procedures, namely; financial policies and procedures, controlling/finance committee, annual budgeting, accounting systems and chart accounts and financial guidelines and/or standards. Control over receipts practices examined whether *zakat* institutions practiced these control procedures: separation of duties pertaining to cash handling, cash depositing, cash recording, and bank reconciliation, on one hand, and pre-listing of *zakat* payers/donors, voucher system, and independent verification of cash collection on the other hand. Control over disbursements practices examined whether *zakat* institutions put into practice the control procedures of: cash payment through cheques, impromptu cheque registration, petty cash vouchers, and independent verification of cash disbursement and monthly balancing of cash, on one hand, and over-budget disbursement, approval and signatures and voucher system on the other hand. Financial reporting attempted to identify the frequency of financial report preparation, financial report contents, auditing of financial reports, reviewing of financial reports, and reporting of budget variance. The results for each control procedure are discussed below.

Control Environment Practices

The results showed that out of the 10 *zakat* institutions, seven had written financial policies and procedures, while the other three lacked of written policies. On whether such written policies and procedures were available to all administration, only six *zakat* institutions responded that written financial policies and procedures were made available for staff members and other committees. Two *zakat* institutions replied that they have written financial policies and procedures, but it is not given to all staff and other committees, while two *zakat* institutions did not give any information on whether their written financial policies and procedures are disseminated among their staff and other committee members. It can be concluded that the majority of the *zakat* institutions in Malaysia have written financial policies and procedures, which represent the foundation of financial control procedures, but having written financial policies and procedures is not enough. There should be enforcement of these policies and procedures. It would make the administrative staff and all other involved committee members aware of the importance of financial responsibilities; it empowers staff when they have a guide about their individual duties.

Out of the 10 *zakat* institutions surveyed, eight had a controlling or finance committee, while one institution reported the lack of such a committee. Since the main task of the controlling/finance committee is to set the annual budget and plans and then follow up if the plans are being implemented, respondents were asked whether the *zakat* institutions prepare annual budgets for their activities. Out of the 10 *zakat* institutions, seven of them prepare financial budgets annually, while three do not. As noted by Wooten, Coker and Elmore (2003), the controlling or finance committee is a necessary body for any nonprofit religious organisation as it is responsible for preparing proactive plans and supervising the implementation of those plans. The controlling or finance committee prepares annual budgets for the institutions' activities. The committee is responsible to ensure that financial resources of the institutions are properly placed as well as to monitor how the institution spends its money.

One of the basic principles of financial control is recordkeeping, because without recordkeeping, the traceability of the financial

transactions, in any institution, will be troublesome. Recordkeeping and having charts of accounts are considered an important part of general financial management of the organisation in the area of planning and goal setting (Baraldi, 1998). Therefore, recordkeeping is one of the internal control procedures of financial resource management in any institution. Similarly, a chart of accounts guides the expenditure of the institution and assists control procedures.

Out of the 10 *zakat* institutions, nine had a chart of accounts. Similarly, all the *zakat* institutions that responded to the study had an accounting system, but the system practiced by the institutions varied. Six *zakat* institutions maintained both manual and computerised accounting system (combination), while three others maintained only computerised accounting system, leaving only one institution with a manual accounting system.

Financial guidelines and/or standards help an institution to perform its activities in accordance with the standards and guidelines. According to the results, eight *zakat* institutions practice a set of financial guidelines and standards, but again the guidelines and standards were varied. Out of the 10 *zakat* institutions surveyed, five reported that they adhere to the accounting guidelines set by the Malaysian Accounting Standards Board (MASB), while two indicated their implementation of treasury instructions. In addition, some institutions followed one of the mentioned financial guidelines parallel to their own financial rules and guidelines. *Zakat* institutions in Kuala Lumpur, Kedah and Terengganu had their own financial guidelines called *Amalan Terbaik Pengurusan Kewangan Majlis Agama Islam* (The best financial management practices of Religious Councils). Similarly, *zakat* institutions in Negeri Sembilan followed the "*tatacara kewangan syarikat*" (the companies' financial procedures). In conclusion, the majority of the *zakat* institutions had an acceptable level of control environment practices.

Control Over Receipts Practices

As for the control over receipts or collection, respondents were asked to answer the five-point Likert-scale questions, which is 1 to 5. (1 Assigned to indicate "never" means that the institution does not practice

the respective control procedure, while (5) would indicate the full implementation of certain financial control procedures. (2) to (4) indicate varying degrees of intermediate implementation of the financial control procedures.

As provided in the Likert-scale format and to simplify the result scrutiny, scores of the mean were emphasised to analyse the results. According to the results, the mean score was above 3 points. The range of the mean is from 1 to 5; therefore, a score of 3 and above is considered strong evidence that good control procedures over receipts are practiced by the *zakat* institutions. The highest score was 4.63, which explains that receipt vouchers were prepared as *zakat* amounts collected by the institutions.

Although it was quite satisfactory, with mean scores of 3.18 and 3.16, compared to other financial control activities, these two were the least control procedures practiced by the *zakat* institutions. The second lowest mean score was whether *zakat* payers are pre-listed and identified before *zakat* collection starts, with a mean score of 3.18, which is also quite acceptable. The second highest score was 4.26, which indicates that amounts were recorded promptly in the accounting records as it is received, and also no disbursements can be made until the amount is recorded.

The mean scores for the other control procedures over receipts are between the highest and lowest mean scores mentioned above. The areas where *zakat* institutions had good practices were: receipt voucher preparation for amounts received, and that an independent person verified the accuracy of the received amounts. In addition, bank reconciliation was also done by an independent person. These three areas scored above a mean of 4 points which, in this study, is considered very high level of practice of financial control. According to the mode, 5 and 4 were the most frequently-occurring responses. These two figures represent "always" and "often," respectively.

Similarly, all 10 *zakat* institutions reported that necessary documents, specifically receipt vouchers, were issued for all *zakat* funds collected. In addition, all institutions recorded *zakat* amounts on a daily basis except one institution which recorded cash receipts monthly. The

zakat institutions also affirmed that an independent person, other than the cash custodian, verifies the petty cash management activities regularly.

In conclusion, financial control procedures over receipts in the majority of Malaysian *zakat* institutions appear to be satisfactory. Although the strength of the control areas varies from one procedure to another, generally the status of financial control over receipts is good. The general mean of all Likert-scale questions' scores was 3.80, which is considered quite strong, while in to the other sections, YES-NO section, the percentage was very high at 93.3%.

Control Over Disbursements

As Bowrin (2004) argues, the most important part of proper control over disbursement is that, all major disbursements should be authorised by the responsible officer and then accurately recorded. Another control that aids in checking the accuracy of the cash disbursed is reconciling the bank statement on a timely basis (Wooten, Coker and Elmore, 2003). Additionally, to initiate a petty cash fund to meet all minor expenses is considered an essential tool for better cash disbursement control. The objective of this section is to identify whether *zakat* institutions employ financial control mechanisms which ensure that cash is disbursed only upon proper authorisation of management and for valid purposes, and that all disbursements are properly recorded.

In this section the respondents were asked to answer one of five-point Likert-scale questions that consist of 1 to 5. (1) Indicates "never," while (5) was assigned to indicate "Always" and (2) to (4) to indicate varying degrees of intermediate implementation of the financial control procedures.

The results showed that the lowest mean score was 4.34. The range of the mean was from 1 to 5; therefore, a score of 4.34 and above is considered very high, which shows that the control over disbursement is very good compared to other control procedures. The highest mean score was for reconciliation with the bank, at 4.63 points. This is a good indication that *zakat* institutions always reconcile the bank statement on a regular basis. Similarly, as the mean score showed 4.59 points all disbursements, except for minor items, were made by serially

pre-numbered cheques. Additionally, after payment is made, cheques were registered in the Cheque Register or cash payment book (with mean score of 4.58). Likewise, *zakat* institutions managed minor cash expenses through petty cash fund (with mean score of 4.34). As discussed earlier, the first and most important measure to ensure control over cash disbursement is the authorisation for each payment. The mean score for this procedure was 4.53. This means most of the disbursements were authorised by the responsible person. It is also interesting to observe that the mode is 5 for all procedures, which means almost all respondents answered that, the disbursement control is “always” practiced. Similarly, all the 10 *zakat* institutions reported that payment vouchers were used to support each disbursement before the amount is released. Cheques were also used for most of the cash disbursements. All *zakat* institutions reported that the amount cannot be released until two or more signatories append their signatures as the normal rule. The requirement of two or more signatures on all payment slips or cheques was another safeguard to ensure that cash is only spent for an agreed purpose and only for the *zakat* funds as earmarked.

With regards to the issue of over-budget usage, six *zakat* institutions reported that their payments were limited to the budgeted amounts, leaving four *zakat* institutions that were yet to consider budget limitations. This means the majority of the institutions surveyed, expend and disburse only what has been budgeted. But what is interesting is that, if over-budget disbursements have to be made, most of the institutions disbursed over-budgeted amounts with the approval of the responsible authorities. Out of the ten institutions, six reported that such budget overage was approved by the director or general manager, while two institutions noted that the budget overage was approved by the controlling/finance committee.

In conclusion, the overall mean score for disbursement was 4.53 points, which indicated very strong practices of the respective financial control procedures. Similarly, the over-budget usage and its proper approval also showed very high percentage (92.5%) of financial control procedure practices. So, the control procedures over disbursement are very sound in Malaysian *zakat* institutions.

Financial Reporting

Reporting the institution's financial results can help the administration and *zakat* payers to obtain financial data and make effective decisions. According to Greenfield and Larkin (2000), the most significant contributing source of information to measure any organisation's performance is the annual report. Thus, reporting is an important part of financial control that can show whether the institution is on the right track or not and also if the institution complies with the leaders' and *zakat* payers' desires.

The results showed the 10 *zakat* institutions prepared financial reports regularly except one institution that did not provide information about its financial reporting. Out of the ten, seven institutions provide financial reports both on a monthly and yearly basis; leaving two that only prepare yearly reports. Although it is not included in the options of the questionnaire, one of the institutions indicated that it produces financial reports on a daily basis.

According to the delay period of financial reports, the majority of the *zakat* institutions (i.e. eight) reported that the delay period does not exceed three months, while two institutions stated that their report delay takes up to the sixth month of the next year. Nine of the ten *zakat* institutions disseminate the financial reports to the (selected) stakeholders of *zakat* institutions. Only one institution did not give any information about reports' provision to the (selected) stakeholders.

To identify the users of the financial reports, respondents were asked to choose from a list of options. The majority of the *zakat* institutions provided financial reports to "controlling/finance committee," "*zakat* payers/donors" and "Religious Councils," with only two institutions providing the reports to their "administrative staff" and the "representatives of the public." Similarly, the majority of the *zakat* institutions provided the statements of "collection and disbursement," "balance sheet" and "income statement". Out of the 10, six institutions provided the report of the "next year's budget" into the financial statements that were presented to the stakeholders. None of the institutions provided a report on the financial problems.

With regards to the financial reports audit, eight *zakat* institutions were audited by the Auditor General (*Jabatan Audit Negara*), while the other two were audited by a public auditing firm. This gives a positive indication to the financial control status of the *zakat* institutions in Malaysia. Even though the auditor cannot guarantee that auditing of reports prevent fraud or mismanagement, at least he can give a reasonable assurance as to the fairness of the financial statement and play a watchdog role in the area of fraud (Bowrin, 2004).

According to the Likert-scale questions, the mean scores for both auditing function and budget variance reporting were above 4. This signified that almost all *zakat* institutions audited their financial statements annually, and by an independent auditor. Overall, the financial reporting of *zakat* institutions in Malaysia is satisfactory.

Conclusion

The central purpose of this study was to explore the status of financial control in Malaysian *zakat* institutions. The results of study show that financial control practices the institutions are generally good. Control over disbursement procedures and reporting system had the highest score compared to the other two control procedures, control environment and control over receipts. Although the strengths of control procedures are at different levels and there is a need to improve control environment and control over receipts, an overall assessment shows that *zakat* institutions of SIRC have quite good financial control practices.

As discussed earlier, good financial control practices may be an indicator of financial accountability. Although there are weaknesses in some areas, the overall conclusion is that *zakat* institutions have quite a good financial accountability system to accomplish its mission. Although the general system of financial accountability is acceptable, there is still room for further improvement in order to achieve better financial control practices.

Future Research Areas

This study examined the state of financial control procedures of *zakat* institutions in Malaysia. Many other specialised research areas can be explored by future researchers. For instance, in order to carry out a concrete analysis of financial control procedures, a researcher may include all employees of *zakat* institutions. Also, using other data collection methods such as interview and observations, may give a better understanding of the financial control problems faced by the *zakat* institutions. In addition, since this study focused only on *zakat* institutions in Malaysia, future researchers could compare Malaysian *zakat* institutions with practices in other countries. It will also be interesting if the study is expanded to other nonprofit Islamic religious institutions like *waqf*. As highlighted earlier, one of the most interesting and important area for future research is to develop a financial control model for nonprofit Islamic religious institutions.

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