The Role of Internal Audit in Governance of Zakat Institution in Malaysia

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Abstract: This study outlines the role of internal audit in the governance of zakat institutions in Malaysia. Aspects of internal audit are detailed in this study as well as risk management. Internal audit is closely linked to risk management where both of these aspects are an important element of an organisation's governance. In addition, legislative matters such as the Federal Constitution and the State Administration of Islamic Religious Enactments were also discussed in this research. Researchers are also talking about the Malaysian Code on Corporate Governance (MCCG), which can be used as a guide and best practice for Islamic religious states and zakat institutions in Malaysia. Although the Islamic religious councils of the states and the zakat institutions are not a company but with the trust as administrators and managers of large zakat funds, the need for good governance is essential.

Keywords: Internal audit; governance; zakat institution; Malaysia

1. Introduction

It is generally known that zakat is one of the pillars of Islam that Muslims must observe. There are many verses in the Quran that explain the responsibility of performing zakat. Among them is the verse of At-Taubah verse 103 which explains:

"Take (some) of their wealth into zakat, that you may purify them (from sin) and purify them (from evil), and pray for them, for verily their prayers shall be for them, and (remember) Allah Most High. Hearing More Knowing.

"Whereas in Surah An-Nur verse 56, it states that:
"And pray ye, and give alms, and obey the Messenger, that ye may have mercy."

From the above verses, it is very clear about the obligation of zakat and anyone who denies or doubts its meaning, it is excluded from Islam. History has shown that the Caliphate of Abu Bakr fought against those who refused to pay zakat. The rich and the living should also be aware of the existence of the rights of the poor and needy in their property (MUIP, 2019).

In this article researchers study and understand governance in zakat institutions in Malaysia. When it comes to governance, it cannot be avoided by reference to the rules or laws related to this zakat institution. In Malaysia the Constitution of Malaysia which is the highest law explicitly provides for the governance of zakat institutions in the country. Article 97 of the Federal Constitution provides for the administration of zakat money and the proceeds of Islamic religion in the country. In addition, the state Islamic Religious Administration Enactment is also the main law in the administration of charity affairs in the states of Malaysia.

In Malaysia the administration and management of zakat is under the jurisdiction of the states as provided in the Federal Constitution. The State Islamic Religious Council is an entity or institution entrusted to administer and manage the zakat fund in each state except the state of Kedah where the administration and management of zakat is under the Kedah Zakat Board (LZNK). All Islamic religious institutions and zakat institutions are one of the eight religions that are eligible to receive zakat namely Amil as stated in Allah in the Quran, At-Taubah surah, verse 60:
"Indeed, the zakat is only for the very poor, the poor, the Amil, for liberating slaves, those who are indebted, for the way of Allah and the people on the way, as a decree that Allah requires, and Allah is All-Knowing, All-Wise.

"Therefore, as the institutions that administer and manage zakat in large numbers require good administrative framework and structure or in other words governance (Siti Zaleha, Amaludin & Zaid, 2016). Governance refers to a framework that encompasses the administrative structure, reporting lines and internal controls practiced by..."
The Role of Internal Audit in Governance of Zakat Institution in Malaysia

an institution (Ishak & Mohamad Nor, 2017). Internal audit is an integral part of governance that plays a role in reviewing and balancing the affairs of the institution including operations.

2. Internal Audit

Auditing is no stranger to one's life or to the organizational environment that involves corporate organization and vice versa. The audit is divided into two internal audits and external audits (Ishak et al., 2019). Internal audit is a department or division within the organization itself while external audit is an external entity such as a public accounting firm and so on. Internal audit function is responsible for ensuring that the organization has completed internal control, adherence to relevant regulations and providing value added to the organization (DeZoort, Houston & Peters, 2001; Ahlawat & Lowe, 2004; Abbott, Parker & Peters, 2010; IIA 2017). However, for audit reports either from internal or external, they are reported to the audit committee or the board of directors rather than to the management or executive. This is one of the privileges of the audit department which reports on the results of audits to the highest level of an organization. This practice is an integral element of the governance framework (Jensen & Meckling, 1976). However, the external and internal auditors are interdependent and studies have found that the efficiency of the internal auditors can reduce the cost of external audits (Mohamed, Mat Zain, Subramaniam & Wan Yusoff, 2012).

In Malaysia, the Securities Commission (SC) has issued the best practice code for governance, the Malaysian Code on Corporate Governance (MCCG), which is practiced by publicly listed companies in Malaysia. As an institution that administers zakat money, state Islamic religious councils and zakat institutions should adopt this code of practice as long as it does not conflict with syariah, laws and regulations. The MCCG elaborates on the role and responsibilities of the internal audit to ensure governance is effective within an organization.

3. Risk Management

Risk management is the portfolio that is being mentioned in today's corporate world. It also does not miss other organizations around the world including Malaysia. Risk management is a very broad scope that covers the internal and external aspects of a company and its organization (COSO, 2004). Internationally, the standard code for risk management is ISO 31000 and some publicly listed companies in Malaysia are using this code. In the context of Islamic religious councils and zakat institutions, the role of risk management particularly in the area of internal risk is placed on the shoulders of internal audits. However, the LZNK, which is a separate entity from the Kedah Islamic Religious Council, has the highest risk management committees and key departments. This situation is advantageous to the LZNK as it has a committee dedicated to risk management. For Islamic religious councils of other states, they may refer to MCCG 2017 where risk management is delegated to the head of the internal audit of a company or organization. Based on this MCCG, the head of the internal audit manages risk matters by establishing a complete risk management profile including identifying, managing and mitigating risks. The internal audit will then discuss with the top management the risk management profile.

4. Legal

The Federal Constitution which is the supreme law in Malaysia through Part VII of the Financial Provisions of Article 97 Clause 3 clearly states that all moneys related to Islam must be recorded separately and may not be mixed with other funds. The provision also clarifies that money related to Islam is subject to state law, enactment or ordinance. In certain cases, federal law also applies such as the Statutory Bodies (Accounts and Annual Reports) Act 1980 (Act 240).

“Any such Zakat, Fitrah, Baitulmal or Islamic Religious proceeds, such proceeds shall be paid into a separate fund and shall not be payable except under the authority of State law or federal law, as the case may be. where applicable.” (Part VII of the Financial Provisions of Article 97 Clause 3 of the Federal Constitution, 1957).

The provision also places the administration of zakat money under the jurisdiction of the Islamic religious council of the states. The state Islamic Religious Administration Enactment is the main law in the administration of this Islamic religious council. Table 1 summarizes the enactments and ordinances of some states in Malaysia and the applicable laws.

Table 1. State and Enactment / Ordinance
5. Conclusion

Based on research, understanding and research by researchers, internal audits of Islamic religious councils and zakat institutions play a very important role and responsibility. This department will review and balance all matters pertaining to the organization including risk management. Governance has become the primary responsibility for internal audit. Internal audit also serves as the coordinator between the state Islamic religious council and the National Audit Department. Financial and investment aspects are also reviewed by internal audits to ensure they are in good shape. In making Islamic state councils and zakat institutions the best in terms of governance, the researchers found that the MCCG issued by the SC could be a good practice as long as it does not conflict with Islamic and civil law. MCCG is a governance code that defines functions and roles of governance in a company or organization. The role of internal audit and risk management is also detailed in the code.

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