

# **Towards an Establishment of an Efficient and Sound Zakat System**

Proposed Core Principles for Effective Zakat Supervision

Presented in the Working Group of Zakat Core Principles  
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This paper does not represent the stance of Bank Indonesia or BAZNAS. All opinions and any mistakes found are of the authors.

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# 1. Introduction

## 1.1. Background

Economic development program is set by government to deliver prosperity to the society in every country across the globe. In coordination with relevant ministries and other financial authorities such as central bank and supervisor of financial institutions, the government has been trying to maintain sustainability in the economic development and stability of the financial system. A number of indicators have been developed to measure the level of achievement such as inflation rate, gross domestic product (GDP), GDP per capita, and other indicators that are considered representation of the human well-being in many aspects. One of the most popular indicators in representing public welfare is GDP per capita that reflects the level of income per individual. A later indicator came with an adjustment to represent its purchasing power parity.

Despite colorful general figure of economic development, disparity in the society becomes a major issue in almost every country in the world. Many reports portray wider gap between the rich and the poor that become more and more intense. There is an obvious need to have an alternative mechanism that is capable of constantly minimizing the gap. According to the World Bank (2008), Sub-Saharan Africa region has the widest gap between the rich and the poor. The top 20 percent of the population dominates 64 percent of total income whilst the bottom 20 percent of the population only acquire 3.6 percent of the total income. In order to address that concern, the World Bank has put poverty alleviation program as their top priority. The bank has come up with a number of programs to combat poverty particularly in under-developed countries.

Islam has a genuine spirit in promoting economic justice and equality through the implementation of redistribution mechanism called Zakat. The mechanism is so important that zakat has been mentioned in a number of Qur'anic verses. Islamic thought puts Zakat equivalent to the prayer. So that, every Muslim is bound to Zakat payment in order to fulfill their religious duty. However, Zakat is no longer merely correlated to the aspect of religiosity, but has strong connection to the economic targets. As stated by the Prophet Muhammad (pbuh), zakat is not only being an obligation (*ibadah mahdah*), but it also covers socio economic objectives (*al-ibaadah al-maalayah al-ijtima'iyah*). Through a religious-based organization, these zakat management institutions purify the wealth of muzakki (zakat payer) and empower mustahik (zakat receiver) as well. Therefore, zakat has an enormous social role to alleviate poverty and to develop communities or human well-being

Zakat system comprising of zakat institution, zakat collector, zakat recipients (*'ashnaf*), and zakat payer (*muzakki*) elements, has started to re-emerge in some Muslim populated countries. Some of them have already had a well-designed operating guidelines and regulations. However, in general, the development of Zakat system is still in the early stage. To foster the development of Zakat system, it can take the benefit from the advancement that has been achieved in the financial market. Learning from institutional theory, institutional environment that covers strong legal environment and

regulatory environment, good governance, and socio-economic impacts are among the important aspects that the Zakat system can learn from. In the absence of institutional environment for Zakat development, there will be the absence of governing rules or common grounds for Zakat institutions worldwide. Thus, an international collaboration in terms of working group is deemed necessary to explore the potential of zakat development in the future. The working group would come up with principles for effective and efficient zakat operation including the legal foundation, governance, risk management, financial integrity and etc.

## 1.2. Objectives

This academic paper is written to address some specific objective relating to Zakat development program as follows:

1. Providing a brief description about the position and roles of zakat system in the economic development program.
2. Providing a methodology to set the core principles in zakat management and supervisory system.

## 1.3. Methodology

This academic paper applies a comparative study between currently well-established financial regulations such as banking regulation, insurance regulation and basic properties of zakat. The analysis conducted in this study assesses the relevance of the contemporary regulatory elements to a possible zakat regulation. The paper classifies the regulatory items which are in contradiction of the concept of zakat and relevant to the proposed zakat regulation. Based on the historical zakat system and Qur'anic analysis, this paper may also offer new elements of regulations for zakat system.

## 2. Shari'ah and Historical Aspects of Zakat

In the context of poverty reduction, one of these instruments is through the payment of zakat. Historically, zakat has been practiced since the early history of Islam to combat poverty and enhance welfare in the society. Whilst from muzakki perspective, zakat has already been a form of obligations for Muslims to purify the wealth and the soul. This section examines the basic concepts of zakat as enunciated in primary sources of Shari'ah which are Qur'an, *hadith*, and *secondary sources of Shari'ah such as qiyas, 'urf, masalih wa mursalah, and ijtihad*. The chapter then discusses some aspects of the historical experiences and contemporary experiences of zakat.

### 2.1. Basic Concept of Zakat

#### *Definitions*

Zakat was practiced initially during the period of Prophet Muhammad (pbuh) based on the direct Quranic interpretation and implementation. Zakat has a divine position in Islam that has the same level of importance as the prayer (refers to at least the following verses of the Holy Quran).

*We made them (Abraham and his sons) imams who guided in accordance with our commandments, and we taught them how to work righteousness, and how to observe the Contact Prayers (Salat) and the obligatory charity (Zakat). To us, they were devoted worshippers [H.Q.: 21:73]*

*You shall observe the Contact Prayers (Salat) and give the obligatory charity (Zakat), and bow down with those who bow down. [H.Q.2:43]*

*Take sadaqah (zakat) from their wealth in order to purify them and sanctify them with it, and invoke Allah for them. Verily, your invocations are a source of security for them; and Allah is All-Hearer, All-Knower [H.Q.:9:103]*

After the collection, zakat is disbursed to the needy as it is revealed from the Holy Quran as follow:

*As-Sadaqat (here it means zakat) are only for the poor, the needy, and those employed to collect (to manage) the fund, and to attract the hearts of those who have been inclined (towards Islam), and to free the captives, and for those in debt, and for Allah's cause, and for the wayfarer; a duty imposed by Allah. And Allah is All-Knower, All-Wise [H.Q.:9:60]*

*You shall give the due alms to the relatives, the needy, the poor, and the travelling alien, but do not be excessive, extravagant ... [H.Q.:17:26-29]*

*They ask you about giving: say, The charity you give shall go to the parents, the relatives, the orphans, the poor, and the traveling alien. Any good you do, God is fully aware thereof.[H.Q.:2:215]*

#### *The Recipients of Zakat*

From the Quranic verses ordaining zakat (9 : 60) as mentioned above, eight groups of beneficiaries have been identified and they consist of the following:

- Masakeen – (the destitute), these are people who do not have anything, and who are in need of asking others for food, clothing and shelter.
- Fuqaraa – (the poor or needy), these people have some money, but not sufficient for their everyday needs. The elderly are often amongst the 'fuqaraa'. The Prophet Muhammad said "He is not one of us who does not show tenderness to the young and who does not show respect to the elder." (At-Tirmidhi). It is a sad fact that the elderly tend to be neglected in today's society. According to recent research, older people are among the most excluded and materially worse off.

The definition of masakeen and fuqaraa is based on the Hanafi school while Shafii school has the opposite definition.

- Amil' Zakat – these are the people whom are authorized to manage zakat. The Quran has given them the right to receive a fee for their work (maximum one-eighth), which includes collecting, recording, guarding, dividing and distributing zakat. The government may add or reduce the amount of the fee based on actual fund needed and prevailing regulation.
- Fi sabi 'Lillah – this means 'in the path of Allah' and pertains to anyone struggling for a righteous cause, including expenditure towards the promotion of Islam and for all charitable purposes.
- Gharimun – these are the debtors, people burdened by debts because of personal needs or social necessity with condition that these debts are permitted by the *Shari'ah*. These people should be given zakat if they do not have enough money beyond their basic needs to repay debts. Help should also be provided to those who may have landed themselves in debt as a result of social obligations such as supporting an orphan or renovating a school.
- Ibnus' Sabil – the wayfarers are the travelers facing shortage of money. These people can receive zakat, if the purpose for travelling is lawful. In contemporary situation, refugees or displaced people may fall under this category.
- Riqab – the riqab are people in bondage or slavery. Zakat can be used to buy the freedom of such a person. In current circumstances, it would be very difficult to find the slaves as practiced in the past and as discussed in the classical literature. However, Yusuf Al Qaradawi is of the view that people or country that are under foreign occupation may be categorized as slave in modern times and hence, eligible to receive zakat under this asnaf. Economic slavery such as trapped prostitution and oppressive conditions in modern times can be categorised under this category of *'ashnaf*.
- Mu'Allaf – translated literally as 'those who have converted to Islam'. Shafii school have limited the status of 'newly convert' to maximum two years. However, majority of schools agree to include the non Muslim, who do not against the Muslim and whose circumstances are so desperate, as part of this asnaf. It may attract their hearts closer to Islam.

## 2.2. History of Zakat

History of zakat has witnessed glorious period and decline period of zakat management. These periods actually follow the golden age and the declining age of Islamic civilization. In the early days of Islam, zakat management could be divided into three periods, i.e. Prophetic era, guided caliph period and dynasties period.

During the prophetic period, zakat was collected and disbursed by the appointed companions of the Prophet (pbuh). Around 25 companions, such as Ibn Lutaibah, Ali bin Abi Thalib and Mu'az bin Jabal, were given mandate to manage zakat under his leadership. Despite zakat management at that time was still simple in terms of organization and administration and purely a state matter, the Prophet and his amil officers had applied modern principles to utilize zakat fund productively aiming at transforming mustahik to become muzakki, as a complement to consumptive program of zakat disbursement which was dominant. This could be observed from a hadith reported by Imam Muslim, in which Salim bin Abdillah reported from his father and his father said:

*“the Prophet has given him zakat and asked him to develop it (use it productively) or re-donate it”*

All of the sources of zakatable items during the Prophet era were totally based on those mentioned explicitly in the Quran and hadith. All of livelihood sources of the society at that time were captured by the Prophet, and through his hadith the Prophet set up the requirements of eligibility of wealth to become zakatable items (*al-amwal al-zakawiyah*). These requirements were in the form of *nisab* (exemption limit), zakat rate, ownership requirement, and so on. Similarly, the Quran and hadith have identified the zakat beneficiaries and zakat payers, and set up the requirements which must be fulfilled in order to decide whether a Muslim should pay zakat or otherwise, eligible to receive zakat. This prophetic period is basically the foundation era, in the sense that all of basic rules and regulations on zakat matter were set up during this period.

The guided caliph era started after the death of the Prophet (pbuh). Abu Bakar (r. 632-34) as the first caliphate was known for his declaration against those who refused to pay zakat to the state. Abu Bakar said:

*“If they withhold giving zakat even a little rein of a camel or a small baby sheep (that is due on them) I will fight them for it. Zakat is the obligation on properties. By Allah! I will fight whoever discriminates between prayers and zakat.”*

This statement indicated that separating zakat obligation from prayer was considered as sinful act and it was the duty of the state to ensure all Muslims to fulfill their obligation. This is the foundation of the importance of the role of the state to safeguard implementation of zakat obligation. Caliph Abu Bakar continued the policy that was already implemented by the Prophet without any modification or new *ijtihad*.



During the period of second caliph, Umar bin Al-Khattab (r. 634-44) set up a book on income and expenditure (*diwan*), the concept of Baitul mal or Public Treasury and a collection of customs duties for Muslim and non Muslim for the use of roads, bridges, and ports (*al 'ashir*). Umar also applied various *ijtihad* regarding zakat which was not implemented by Caliph Abu Bakar. One famous example was reinterpretation of mu'allaf as zakat beneficiary. Caliph Umar stopped distribution of zakat to the mu'allaf whom always received zakat during Prophet era and Caliph Abu Bakar administration.

According to some analysis, Umar's decision to discontinue this distribution was caused by his judgment on the mu'allaf condition at his time. Initially, the reason to allocate zakat fund to the mu'allaf was to strengthen the condition of the newly converted people and the non Muslims aiming at avoiding possible crime committed by them. However, Umar observed that this reason did not prevail anymore since Islam and the Muslims were in a very strong and solid condition. Hence, from the perspective of fiqh, when *'illat* (reasons behind decision made) did not exist, then exclusion of the mu'allaf was considered in line with the *Shari'ah*. There was no disagreement from the other companions and hence, it became *ijma'* of the companions.

Another *ijtihad* conducted by Umar was related to the social security system (*al-takaful al-ijtima'i*). He classified twelve beneficiary groups which became the target of this system. Those are the poor and the needy, orphan and widow, disable people and people with severe illness, the descendants of the *mujahid*, prisoner of war, slaves, neighbor, inmates of the prison, indebted person, the wayfarer, found children, and *ahludzimmah* (the protected non Muslim). It could be concluded that Caliph Umar had elaborated the definition and meaning of asnaf as zakat beneficiaries and developed the concept resulting in these 12 groups. This opens the possibility of having *ijtihad* in terms of distribution of zakat by extending the definition of *asnaf*.

As the territory of the state widens and the economy grew up rapidly, the third Caliph, Utsman bin Affan (r. 644-55) introduced the division of property into two parts: visible property (*amwal al-zahirah*) and non-visible property (*amwal al-batinah*). Zakat on visible properties must be paid to the state, while zakat on non-visible properties was left to each individual's awareness. Unlike Umar whose *ijtihad* was more on distribution side, Utsman's *ijtihad* was more on collection side. As for the last guided caliph, i.e. Ali bin Abi Thalib, there was no significant changes in the zakat management compared to the Utsman period.

The only difference was the political differences, especially between Caliph Ali in Madinah and Governor Mu'awiyah in Sham. This created confusion to the people when they want to fulfill their zakat obligation. In response to this situation, as has been written in the *Kitab al-Amwal* and quoted by Abu Ubaid, Ibn Umar gave two options to the people. Firstly, to those living in Madinah, he suggested them to pay zakat to the amil appointed by Caliph Ali. Secondly, to those living in Sham, he asked them to pay zakat to the amil appointed by Governor Mu'awiyah. This was the best solution given political disturbances at that time. Ibn Umar did not give opportunity to the muzakki to distribute zakat directly to the mustahik on individual basis unless there was no

available amil operating in the area. This opinion strengthens the importance of paying zakat through amil institution.

Application of personal judgments (*ijtihad*) with some improvements in the interpretations by the guided caliphs indicated that the response to the actual condition of the state and the society leading to new formulation of law was allowed. There was also significant improvement in zakat management, from a simple structure under the Prophet and Caliph Abu Bakar administrations to a more complex structure of zakat institution under the administrations of Caliph Umar bin Khattab, Utsman bin Affan and Ali bin Thalib. This was due to territorial expansion and wider coverage area. This era furthermore became foundation expansion of strong dynasties, which affected zakat collection. History witnessed significant increase in the quality of zakat management especially during the Umayyah and Abbasiyah dynasties as well as the decline time during substitution of one dynasty by another dynasty.

Under the reign of Umar bin Abdul Azis (Umayyah government), the governor of Egypt wrote to him asking what to do with zakat funds as no deserving poor and needy all over the country. Umar bin Abdul Azis answered: “Buy slaves and let them free, build shelter for travelers to rest and help young men and women to get married”. Thus, it indicates that the effect of zakat distribution will eliminate the poverty if zakat is managed properly. During his administration, zakat on income earned by government employee was levied on regular basis (monthly basis). This was his *ijtihad* to introduce new sources of zakatable items (*al-amwal al-zakawiyah*). This opens the door for further exploration and *ijtihadon* new sources of zakatable wealth. Exhibit 1 shows the historical evolution of zakat collection and disbursement from earlier period of the Prophet Muhammad (pbuh) until the period of the caliphates.

### Exhibit 1

#### Early Zakat Management in Comparison

Aspects	Early age	Period of the caliphs
Collecting agent	The appointed zakat workers (amil) under simple state structure	Government bodies in more complex structure
Disbursement program	Dominated by consumptive-based programs; few attempts on productive-based programs	Some improvisations in the disbursement programs
Zakatable objects	Limited to the sources explicitly mentioned in the Quran and hadith	Sources of zakatable object were expanded following economic development of the ummah
Management of zakat	Simple structure of amil administration; limited territorial coverage	More complex institutional structure; wider territorial coverage
Rules and governance	Rules and regulation on zakat were under direct guidance of the Prophet.	In addition to the Quran and hadith, rules and regulations on zakat started to emerge despite its simplicity.

### 2.3. Contemporary Practices of Zakat

Laws concerning zakat collection are classified into three major types. Firstly, the collection and disbursement of zakat are managed by specialized voluntary committees without any government intervention. Secondly, the collection of zakat is made by the state on the basis of voluntarily individual initiative. Thirdly, the functions of collection and disbursement of zakat are made obligatory by government. For instance, the responsibility for the collection and distribution of zakat is resumed at the state level in countries like Saudi Arabia, Pakistan, Libya and Sudan. While some other countries have established governmental agencies to manage voluntarily zakat, namely Indonesia, Bangladesh, Jordan, etc. Exhibit 2 explains about the general characteristic of zakat collection management in various countries.

#### Exhibit 2.

##### Characteristic of Zakat Management Scheme in Various Countries

	Character of Collection	
	Compulsory	Voluntary
<b>Full Government</b>	Saudi Arabia, Pakistan, Sudan, Libya, Yemen Arab Republic, Kuwait, Malaysia (Johor, Kedah, Kelantan, Perak, Perlis, Sabah, and Terengganu)	Bangladesh, Bahrain, Jordan, Indonesia
<b>Government-linked institution (Corporation)</b>	Malaysia (Pulau Pinang, Selangor, Sarawak, Negeri Sembilan, Pahang, Melaka, and Wilayah Persekutuan)	Singapore, Egypt
<b>NGO</b>	-	South Africa, Algeria, Indonesia

The governance structure of zakat management depends fully upon the perception of the state towards the role of zakat system. To those who position zakat system as complementary to the fiscal policy, they would treat zakat institution as the part of governmental administration, and vice versa.

Despite its small number of activities, zakat system has shown significant development in some Muslim countries. To make the zakat effective in poverty alleviation or in a broader sense, i.e., social security and social welfare, the country should have a well-established zakat policy framework. **Exhibit 3** shows the zakat legal foundation and its operational structure in the 11 countries. The list has already had strong legal foundation to make zakat system operational. Except for Malaysia that decentralizes the zakat management to the local government, the rest of the governments have a centralistic power in the national zakat management.

**Exhibit 3 (a)**  
**Zakat Law Enactment in the OIC Countries**

No	Country	Zakat Law Promulgation	Controlling Forum	Collection Arrangements	Disbursement Arrangement
1	Indonesia	<ul style="list-style-type: none"> <li>• Zakat Management Act No. 23 Year 2011</li> <li>• Government Regulation No. 14 Year 2014</li> </ul>	The National Board of Zakat (BAZNAS)	Zakat is collected through a coordination of the BAZNAS central, BAZNAS province, BAZNAS regency/city and private zakat institution (LAZ).	Zakat is distributed based on priority considering principles of equity, justice, and territorial proximity. Zakat can be utilized for productive activities to improve the quality of life.
2	Malaysia	Federal Law of 1986 Each state has its own zakat law	The State Islamic Religious Councils (SIRCs)	Zakat collected under authority of local gov for 13 Malaysian states and 1 fed gov.	All the eight ashnaf; payment in cash or kind; in goods or equities.
3	Saudi Arabia	<ul style="list-style-type: none"> <li>• RDec No. 17/2/28 /8634 of 1951</li> <li>• Ministerial Decision No. 393</li> <li>• Ministerial Decision No. 394</li> </ul>	The Zakat and Income Tax Department of the Ministry of Finance and National Economy	Individuals and companies obliged to pay half of their zakat liability based on their assets.	All zakat proceeds spent only for poor and needy transferred to Social Insurance Dept, except for zakat disbursement of crops and fruits through local committees.

No	Country	Zakat Law Promulgation	Controlling Forum	Collection Arrangements	Disbursement Arrangement
4	Sudan	The Zakat and Tax Law of the Sudan, 1984. It consists of 6 chapters and 46 articles.	Zakat Bureau of the Ministry of Guidance and Direction	Payment of zakat is compulsory for every Sudanese Muslim and non-Sudanese Muslim residing or working in Sudan. For non-Muslim, social solidarity tax is obliged to pay.	The law provides that zakat disbursement is within the same province, unless it is decided by President of the Republic to transfer from one province to another.
5	Kuwait	<ul style="list-style-type: none"> <li>• Zakat Law (16 January 1982) consists of five articles</li> <li>• Law No 46/2006</li> </ul>	<ul style="list-style-type: none"> <li>• The Zakat House of Kuwait under chairmanship of Minister of Awqaf and Islamic Affairs</li> <li>• Zakat contribution of public closed shareholding companies in the state budget</li> </ul>	Voluntary contribution by wealthy people of Kuwait. Corporation must pay 1% from the net profit for state budget and they must pay their zakat as well	All the eight categories referring on At-Tawbah: 60.
6	Jordan	Zakat Act No. 35 (1944) has fourteen articles	Boards of Directors of Zakat Fund	Zakat collected by law in cash, livestock, lands, commodities and imported assets.	Disbursement confined to the poor, the needy and the manager (not exceed 10%)

No	Country	Zakat Law Promulgation	Controlling Forum	Collection Arrangements	Disbursement Arrangement
7	Pakistan	Article 31 of the Constitution	Central Zakat Council headed by a Judge of the Supreme Court	Regulations provide mandate to collect zakat on invisible wealth which are bank accounts and financial papers with exception of accounts in foreign currencies.	The zakat disbursement is made directly or indirectly through schools, educational, vocational and health institutions.
8	Libya	The Executive Regulations of the Libyan Zakat Law (28 October 1971)	Social Security General Secretariat	Zakat collection is compulsory on silver, gold, pasturing animals and agricultural produce only.	The zakat proceeds are disbursed by the General Organization for Social Insurance and the Islamic Da'wah Society.
9	Bangladesh	The Zakat Ordinance of 1982	Zakat institution consists of the Central Council and the Council of the Districts	Payment of the zakat is voluntary	50% of zakat proceeds disbursed through local zakat committees, while remaining disbursed through Central Council.
10	Bahrain	Statute No. 8 for 1979	Zakat Fund Board of Directors headed by a Gov Minister	Payment of the zakat is voluntary	Muzakki has the right to indicate his preference of beneficiaries

No	Country	Zakat Law Promulgation	Controlling Forum	Collection Arrangements	Disbursement Arrangement
11	Brunei Darussalam	The Revised Edition 1/1984 of the Islamic Religious Council Act and Kadi Courts Act (Chapter 77)	Brunei Islamic Religious Council	Obligatory zakat payment	Disbursement is solely authority of Brunei Islamic Religious Council There are only 6 asnaf in Brunei. Mufti Fatwa No 14 MKB 3/1969 excludes the slave and fi sabilillah (struggle in the way of Allah).

## 2.4 The Role of Zakat for Sustainable Economic Development

Apart from Zakat has religious and social dimensions, zakat also has economic dimension. This is because Zakat has paramount importance for economic development as Zakat is a mean to boost real economic development and a tool to reduce the inequitable income distribution between the rich and the poor. In assessing the impacts of zakat vis-à-vis economic development, Zakat can be assessed at both microeconomic and macroeconomic perspectives.

From microeconomic perspective, the impacts of Zakat can lead to the preservation of *maqasid al-Shari'ah* at three different levels. At the first level, zakat can fulfil basic necessities (*dharuriyat*) of the destitute (*fuqaraa'*) and the poor (*masakiin*) such as staple of foods, clothes, shelter, and education. As Quraishi (1999) deliberates, with zakat instrument society can contribute to the need of fulfillment and the general well-being of the society according to one's ability so that there is a self-help mechanism in the society. At the second level, Zakat can educate people in term of intellectual capacity (*'aql*) as well as human dignity (*nafs*). Further, Zakat can be beneficial for *fiisabilillah* recipients who promote *da'wah* and have good intention to acquire more knowledge. In this regard, criminality and moral destabilisation due to lack of education can gradually be resolved. At the third level, Zakat can realize social justice (*maslahah*) in the society by fulfilling basic necessities and educating people, so that moral stability and human dignity can be preserved.

From macroeconomic perspective, many previous research studies indicate that Zakat has interrelations with macroeconomic variables, which are as follows:

- a. **Consumption:** Zakat can increase consumption of zakat recipients at micro level emanating from basic necessities fulfillment. This leads to the increase of Marginal Propensity to Consume (MPC) of the poor and eventually increases multiplier effect in the economy.
- b. **Investment:** Zakat is expected to increase investment by penalizing the behavior of keeping the resources idle (Chapra; Awan 1980,p.203; Sadeq 1990, p.20), stimulates investment and employment opportunities. Zakat also reallocates investible resources from the luxury goods to basic needs industries by "stimulating production of consumption goods and services of the poor" (Mannan 1989, p.31). By investment creation, Zakat can open up employment opportunities and thereby reducing unemployment in the economy.
- c. **Reducing fiscal imbalances:** Zakat acts as an automatic fiscal stabilizer within the economic cycle. During an economic expansion period, Zakat disbursement will lessen recession period as people hoard less and more employment creation and hence reducing inflationary pressures (Awad, 1989). Whilst during recession there will be more Zakat disbursement, which can be taken from the reserve saved during an expansion period, as hoarding increases due to shortfall of investments. However, this poses criticisms regarding the legitimacy of holding-off Zakat in certain period and an assumption of Zakat on hoarding assets alone, not also other types of Zakat (Sadeq, 2002).

Furthermore, as argued by El-Din, it is impermissible to freely manipulate Zakat disbursement as a fiscal policy tool as Zakat should be exhaustively distributed to 8 *ashnafas* fast as Zakat is collected. Hence, Zakat revenues should be viewed as a complementary to tax revenues so that Zakat can reduce fiscal imbalances during recession period, and as a tool to hinder overheating inflation during economic boom period as money supply increases due to more Zakat payment. If possible, Zakat can be an incentive for tax payer in a way that Zakat can be tax deductibility as implemented successfully in Malaysia.

Based on assessments at micro and macro level in the economy above, Zakat has tremendous impacts for social welfare at microeconomic level that leads to higher aggregate demand and hence higher economic growth and lower inflation along with optimal welfare results for sustainable socio-economic development.

### 3. Regulatory Aspects of Zakat

#### 3.1. General Activities of Zakat Management

Zakat, as the third pillar of Islam, refers to the determined portion of wealth prescribed by Allah to be distributed among the due beneficiaries. As Allah says, "*And in their*



*wealth and possessions (was remembered) the right of the (needy), him who asked, and him who (for some reason) was prevented (from asking)" (Qur'an 51:19). Zakat cleans the wealth and purify the soul of the payers, while making the poor grow as well.*

In Islamic jurisprudence, zakat is the expenditure that is legal and compulsory. A payment of zakat is the fulfillment of Muslim's obligation as khalifah in this world. Allah SWT owns all the assets and properties, a man is given amanah by God to manage the resources to become wealthy and use it for the usufruct of ummah. The zakat itself means to 'increase', as a part of social system it indicates the wealth distribution mechanism, an equitable way to overcome poverty, hunger, starvation and other problems in the fulfillment of basic necessities. In principle, the zakat activities can be categorized into two main classifications: the collection and the distribution.

### 3.1.1. Collection

#### a. Zakatable wealth and its method of calculation

Zakat is compulsorily levied to any Muslim (sane and free) who has wealth, which is more than or equal to Nisab. Zakat is not required from non-Muslims. Even though the obligation to pay zakat is mentioned several times in Qur'an, the explanations of its calculation, rate, zakatable wealth and nisab are defined further in Sunnah. Qardawi in Fiqh al Zakat (vol I, p.64-65) clearly defined the scholars' agreement on nisab as:

*"Sayings of the Prophet (p) exempt anything that is less than five camels, forty sheep, two hundred dirhams of silver, or five wasq of grain, fruits, or agricultural crops. Shaikh al Islam al Dahlawi says about the rationale of these quantities, "Five wasq of grain or date is considered minimum because that much would be the minimum required for sustaining a household for a year, a household composed of three people. On the average, people ate one ratl or mudd of grain per person per day. Five wasq would therefore be sufficient for three people for a whole year, and a small extra quantity would be left as a provision for emergencies. For silver, the minimum required for zakatability nisab is two hundred dirhams, because this would be sufficient for the same household for one full year, at prices similar to those prevailing at the time of the Prophet. Five camels are the minimum for zakatability, and zakat on them is one sheep. In principle, zakat is collected from the same kind of the zakatable asset, but camels were exchanged for sheep at the time of the Prophet at the rate of eight to one, ten to one, or twelve to one, as reported in many sayings. One camel out of five would be too much, so one sheep is considered the amount of zakat due on five camels, since five camels would be at the least equal to forty sheep, on which the zakat due is one sheep."*

He also explained that there is a disagreement in deciding the condition of nisab for the specific case of crops, fruits and minerals, in which Abu Hanifah considers ten percent for anything that comes from the earth, while the

majority of the scholars agree on the nisab of five wasq. Nevertheless, the zakatable wealth should be accounted on the excess above basic needs and free of debt. In this term, it could be also considered as the asset designated for business and growth purposes. "They ask thee what they are to spend. Say, what is beyond your needs." (Qur'an: 2:219). Specifically for the money, even though it will be designated for providing essential needs, if the amount is equal to nisab so it will be classified as zakatable wealth.

*Some Hanafite scholars define essential needs in an accurate and scientific manner, as "those things that are used to avoid the realized or potential destruction of humans; realized such as expenses for living, clothing, personal weapons, and potential such as the need to pay one's debts, tools for handicraft, home furniture, personal transportation animals, and books for study because ignorance is like destruction. If a person has money that is designated for such needs, it is considered non-existent with regard to zakat. (Qardawi, Fiqh al Zakat (vol I, p.66)*

In the contemporary context, the ownership of buildings, furniture, any mode of transportations, machinery and industrial equipment; these are accounted as zakatable wealth when they are used to generate income (productive assets). It should be appraised by annual basis (lunar year) as also applied for livestock and money; and the zakat from those assets is assigned for 2.5% from the total value. Zakat of the earned funds (income) is due when it is acquired and the rate is 2.5%, thus the condition of the passage of one year does not apply. This condition is also applied for crops, fruits, honey, extracted minerals, found treasure etc.

There is also the other type of zakat, *zakat of al fitr* or the fast-breaking zakat which is accounted for each individual and paid during of Ramadhan by the head of family for his self and dependents. For each individual, the zakat is accounted of 2.5 kg of main food, which is usually consumed by majority of people. The purpose is to purify those who are fasted and bring happiness to the poor on the day of 'Ied.

In order to have the same common ground of the zakatable wealth, nisab, the rate of zakat and the methods of calculation in one jurisdiction, it is recommended to have a set of regulation framework which comply to Islamic principles and for some extents (such as defining the evolution of essential needs, and form of payment) should be left to the exertion of best effort (*ijtihad*) of the proper authorities. Some examples of this regulatory framework could be incorporated in term of zakat act or fatwas issued by *ulamas*, ministry of religious affairs and other relevant authorities. The main purposes of having this regulatory framework are to improve the collection and to increase the effectiveness of its distribution, and to enhance the *Shari'ah* compliance of zakat management. The zakat act should clearly define the zakatable wealth, nisab, its methods of calculation; the recognized way of collection, criteria's to recognize collecting institutions and others.

b. Methods of collection

Zakat is calculated from the same zakat items; however there are disagreements on the payment method. Hanafi allows payment in the value, while Shafii and Zahiri only recognize payment in the same zakat items. Maliki and Hanbali give permission to pay in value for some cases and do not accept payment in the value for others.

The institutions, which perform zakat collection function, should recognize the differences and accommodate any form of payment. For the payment in value, as it might be more convenient than collecting goods and merchandise, the collecting institutions might create some channels to facilitate the transfer of value as it more suitable for contemporary economic life. Zakat can be paid using notes or other forms of money, such as electronic money and transfer. For collection of goods or any other form of assets, these institutions should consider the appropriate mode of collection and its costs (storage and transportation expenses).

The important thing to be noted, the relevant authorities should give formal permission for any modes of collection implemented by collecting institution in one jurisdiction. This should be incorporated in the regulatory framework.

c. Promotion of Zakat Collection

In order to increase the level of awareness in paying zakat among Muslim in one jurisdiction, the relevant authorities or even other form of zakat management institution can perform dakwah (religious speech, public consultations, seminars and trainings) to carry out regularly dissemination of zakat information and other marketing efforts. Ideally, the resurgence in Zakat institution should be pioneered and led by the Islamic state.

The marketing effort should be backed up with reliable IT system (computerized zakat management system in order to disseminate its governance on zakat management), equipped by ease method of payment (creation of some public payment counters) and effective channeling functions (e.g. to facilitate payment by post/mail, bank counters, phone banking and internet). The zakat administrators also have the responsibility to provide some initiative of interesting and effective marketing in order to improve zakat collections. In some extent when the regulatory framework could accommodate, for the Islamic institutions, the authorities may encourage the zakat collection through salary deduction campaigns.

Additionally, the regulatory framework should give balanced information about the punishment of the negligence to pay the zakat in order to prevent Muslim from abusing this tenet of Islam.

*"And there are those who hoard gold and silver and spend it not in the way of God. Announce unto them a most grievous penalty on the day when heat will be produced out of that wealth in the fire of Hell, and with it will be branded their foreheads, their flanks, and their backs. This is the treasure which you buried for yourselves. Take then the treasures you hoarded."*  
(Qur'an, 9: 34-35)

d. Safe keeping

Zakat funds collected in the zakat institutions should be kept safe by good management so that the zakat fund can be channeled to the ones that are deserved to receive. Traditionally, the funds are kept in their vault. Contemporary practices use Islamic banks to conduct safe keeping function and methods of transfer.

### 3.1.2. Disbursement and Allocation program

When zakat has been collected it should be distributed immediately in the right manner.

a. Recipients and Zakat Allocation

According to *Shari'ah* rulings, there are eight asnaf entitled for zakat distribution (Qardawi, Fiqh al Zakat vol II):

- i. The poor (*fuqara*) and needy (*masakin*), fulfill some circumstances:
  - A person who does not have material possessions or income,
  - A person whose wealth and income are insufficient to fulfill his/her essential needs, or less than nisab of money and other assets.
  - Full-time students to acquire a useful branch of knowledge might be considered outstanding in academic performance.

The main objective is to provide zakat for poor and needy is poverty elimination. The distribution scheme could be in term of fulfillment of their essential needs (food, clothing, shelter, medical), scholarships (education aids), small business capital and others forms of application to provide an adequate level of living.

- ii. Those who are deputed to collect zakat;
  - Those whose jobs are to manage zakat and get salary from the zakat which is equal to the market value of their work.
  - According to Shafii, not exceeding one-eighth of the total zakat, while the majority does not apply this limitation. However, the Shafii opinion is widely practiced in the contemporary zakat management.
  - They are forbidden to accept gifts from the payers, which may raise conflict of interests in zakat calculation.

- To pay expenses for zakat collection, administration and development so that the distribution can be carried out efficiently and effectively especially in helping the destitute and poor.
- iii. Those whose hearts are to be reconciled (muallaf);
- who is just converted to Islam, whose commitment needs to be strengthened, whose evil can be forestalled or who can benefit and defend Muslims
  - Religious instruction
  - Aid for temporary shelter
  - Aid to organizations undertaking dakwah
  - Marriage
- iv. For freeing the slave;
- Purchase slaves and free them from slavery, prostitutions etc.
  - The aid is to release them from the conditions
  - To free them from being control by Muslim's enemy both physical and mental
  - Must have supporting documents from police
  - Aid is given to free Muslim from ignorance, to free Muslim community from very oppressive conditions and to free those trapped in prostitution.
- v. For the indebted;
- Indebtedness in order to fulfill basic needs (Faqir, Miskin and Muallaf)
  - Must have supporting documents – Bills, Surat Akun Hutang etc
  - Those under Hire purchase loan, credit card, education loans are not entitled.
  - The aids or program: Food debts, Educational debts, Medical treatment debts, Rental debts, Funeral expenses debts, Petty traders' debt
- vi. Those on the way of Allah; and
- Dakwah activities (individuals and organizations)
  - Seminars, workshops and activities carried by universities, schools and associations that help to develop Muslims, especially students and youths.
  - Publications of dakwah materials/books
  - Aid for disasters
- vii. Wayfarer
- Do not have enough money to finance basic expenses during the journey
  - No relatives or ambassador that is willing and responsible to help
  - Possess a valid travelling documents
  - The payment of visa for foreigners is only once and subject to case.
  - Aid or program: Aid to stranded travelers

Some scholars require that there is no abandoned recipient, while the others may give permission the distribution only to some of categories. However, if the funds are abundant and there are recipients in all categories, the distribution should cover all of asnaf. The amount of distribution should not be equal for each of categories depends on the criteria and their respective needs. Zakat may be given according to some priorities; however the judgment should be objective, based on the actual needs and public interest. The highest priority should be set on eliminating the poverty (lack of essential needs) to the poor and the needy, however, if some certain conditions such as for defense, this case could be exceptional.

Furthermore, Qardawi in *Fiqh al Zakat* vol. II also defines some categories to which zakat must not be paid: the rich; those capable of earning; disbelievers and apostates who fight against Islam; children, parents, and wives of zakat payers and descendents of the Prophet (pbuh).

The regulatory framework should incorporate this mechanism distribution (classification of zakat recipients, priorities and allocation mechanism) in order to improve the effectiveness of zakat distribution. Any disbursement made by the zakat institutions in one jurisdiction should be recognized and endorsed by the relevant authorities or operational regulations.

b. Area of distribution

Muslim scholars agree that the distribution of zakat should be performed in the same region where the zakat is collected according to the tradition of Prophet (p) and his Wise Successors. Transporting the zakat to other region while there are still some people deserve in their region is violated the collection reason. Unless, there is no other eligible recipient in their region, it can be allowed to transfer to other jurisdiction according to its urgency and priorities.

c. Performance indicators

Performance indicators for zakat institutions are required to assure that the institutions are functioning well as it should be. The indicators should cover several key areas such as: disbursement period, fund allocation effectiveness, ratio of operational cost to collect funds, governance quality, quality of disbursement program, maximum funds that is allowed to be retained or carried over etc.

The followings are the examples of proposed thresholds for disbursement period and disbursement ratio. The zakat supervisor may determine that zakat fund from the latest collection period must be distributed at maximum

of 1 year holding period. The management of zakat fund will be assessed based on the speed of its disbursement process as follows<sup>1</sup>:

- a) < 3 months : fast – a zakat institution has already had an effective program and clear targets for disbursement so that zakat collected may reach the recipients immediately.
- b) 3 - 6 months : good – a zakat institution has an effective program and fairly clear targets for disbursement.
- c) 6 - 9 months : fair – a zakat institution has a fairly effective program and targets
- d) 9 - 12 months : slow – the disbursement program of a zakat institution is not quite effective
- e) > 12 months : zalim – the disbursement program of a zakat institution is ineffective or even inexistent.

The zakat supervisor assesses the level of disbursement management by using disbursement-to-collection ratio (DCR). This ratio quantifies the ability of zakat institution to distribute zakat fund by dividing total disbursement by its total collection. The DCR is expressed as a percentage that can be categorized as follows:

- a) > 90 % : Highly effective
- b) 70 – 89 % : Effective
- c) 50 – 69 % : Fairly effective
- d) 20 – 49 % : Below expectation
- e) < 20 % : poor - zalim

### 3.2. Institutional Foundation

*"Sufficient unto us is God. God and His apostle will soon give us of His bounty. To God we turn our hopes that would have been the right course. Sadaqat are for the poor, needy, and those employed to administer the funds, those whose hearts have been recently reconciled to truth, those in bondage and in debt, in the cause of God, and for the wayfarer. Thus it is ordained by God, and God is full of knowledge and wisdom."*  
(Qur'an, 9:58-60)

This verse provides the assertion that there should be a group of zakat administrators, where this function should be delivered by the state, which also supported by the actual practice of the Prophet (p) and the Wise Successors after him. Nevertheless, due to different regulatory framework and governance structure, the zakat administrators might varies among Muslim countries. Monzer Kahf (2000) illustrates three types of zakat management institution in Muslim countries:

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<sup>1</sup> The number of months indicated in the assessment proposal is set on the basis of ijtihad by National Zakat Authority of Indonesia. The purpose of timelines is to optimise the benefits to the recipients of zakat as a result of efficient and well-managed zakat allocation program by the Zakat collecting institutions.

- i. Private sector, which voluntarily performs collection and distribution function without government interference.
- ii. Special department assigned and supervised by government, however, the collection is not compulsory by the law (voluntary payment from zakat payers).
- iii. Government on mandatory basis enforced by the set of regulation.

The common problem is the lack of credibility of these institutions, which hinder the effectiveness of zakat management. In order to solve this integrity problem, the regulatory framework should require any form of zakat management institution to have appropriate understanding of zakat rulings in accordance with *Shari'ah* principles (in defining zakatable wealth, nisab assessment and methods of calculation), as well as supported by adequate internal controls (some sets of policies and procedures) and good governance.

### 3.3. Zakat Administer Qualifications

The selection criteria for the zakat administrators should be established in order to increase the trust of zakat payers, and the institution credibility. Those sets of requirement should consider the understanding of *Shari'ah* principles and professionalism principles. The regulatory framework in Muslim jurisdiction may define some characteristics which are qualified to be zakat administrators, however, these persons also need to understand of their *Shari'ah* responsibility in managing the zakat.

*'Adi bin 'Umairah reports, "I heard the Messenger of God saying, "Whoever is employed on any collection job, and hides from us even a needle or more, it is embezzling, and he will carry what he embezzled on the Day of Judgement."*

(in reference to Qur'an, 3:161, taken from Qardawi in Fiqh al Zakat Vol.II, p.28)

Some characteristics that could be defined:

- a. *Muslim*
- b. Sane and past the age of puberty
- c. *Amanah*, trustworthy, as Qardawi (Fiqh al Zakat Vol. II, p.29) further illustrates, "The Prophet (p) advised his zakat collectors to be kind, courteous, and moderate, and selected them from the best of his Companions."
- d. Have a complete knowledge and understanding the zakat rulings and regulations, as an essential requirement for the senior management. The relevant authorities may develop and perform a set of fit and proper test in order to check the quality of the senior management of the zakat institution.
- e. Efficient and has the capability to work on zakat target.
- f. Must not be one of the descendents of the Prophet Muhammad's family, since they are the exemptions of zakat recipients.

Nevertheless, the institution should also facilitate their employee appropriate remuneration and incentives, as well as adequate trainings and create profound work culture, such as work as ibadah, and treat employees as their valuable assets.



### 3.4. Supporting Infrastructures

Like other financial institutions, zakat institutions require supporting infrastructure to assure the effectiveness of zakat operations. The supporting infrastructure consists of internal reporting system and risk management so that the operation can meet the required level of good governance practices. Externally, the zakat sector should also be supported by infrastructure that promotes effective supervisory process by zakat regulator and supervisor.

#### 3.4.1. Reporting system

##### *Internal reporting system*

The reporting system should allow the top management of a zakat institution to monitor and comprehend the whole activities of zakat institutions including zakat collection, safe keeping, execution of disbursement program, minimizing cost and expenses, human resource development. The reporting system should also be able to support the preparation of zakat reporting system to the supervisory authority.

##### *External reporting system*

The reporting system should allow the flow of financial information safely reach the supervisory authority. The information could take the forms of financial stocks, flows, ratios and indicators that indicate the effectiveness of the zakat operations. The zakat supervisory authority determines the reporting forms to be prepared by the zakat institutions to be reported regularly.

#### 3.4.2. Risk Management system

Despite different financial contract and balance sheet structure, the operations of zakat institutions involve certain types of risks, including operational risk, reputation risk, and liquidity risk.

- a) Disbursement risk : A sound disbursement risk management oversees the sound financial position and misallocation mitigation. First, Zakat institutions are institutions that also have financial obligation to meet in time. The financial obligations arise from its operational activities to make sure that its functions can be done effectively. A failure to meet its financial obligation may initiate dispute or claim by other parties that will potentially cause significant disruption to its operational sustainability. Second, mismatch allocation of disbursement needs to be mitigated by a comprehensive *ashnaf* measurement and a proper financial planning, recording and management.

- b) Operational risk : Operational risk in zakat institutions may cover potential fraud, technical failure of the computer system, and any other factors that may disturb the institutions from its daily operations. In order to minimize potential fraud, the zakat institutions should be equipped with good governance structure to assure that responsibility and accountability are in place. Good governance structure also allows four-eye principle works.
- c) Reputation risk : Zakat institutions rely themselves to the public trust. The zakat payers, particularly in the countries that do not make zakat payment obligatory, have full freedom to determine zakat institution they want to pay their zakat to. Bad information about a particular zakat institution could potentially crush the public trust to that zakat institution.
- d) Liquidity risk : Potential mismatch between upfront commitments and expected zakat collection. In operations, zakat institutions may have operational plan to acquire certain assets that result in financial obligations to the third party; whilst zakat collecting institutions could only rely on its predictions without any commitments from the potential muzakki. In order to minimise this risk, a zakat collecting institution may want to allocate a certain level of buffer to fullfil this type of obligation.

### **3.5. General Regulatory Framework for Zakat Management**

In order to evaluate the effectiveness of the zakat management as performed by the *amil*, there should be a set of regulatory framework, which incorporates the regulatory act, supervisory function and governance requirements.

#### **3.5.1. Supervisory Structure**

Supervisory body has a structure to allow effective supervision to be conducted to the head quarter and its operational branches. The supervisory process emphasizes the anticipatory process to minimize fraudulent practices.

#### **3.5.2. Regulatory Framework**

The regulations for zakat institutions cover all the operational aspects of the zakat institutions comprehensively with the purpose as follows:

- a. Optimising the collection based on supporting governing rules;
- b. Maximising the effectiveness of zakat operations and to promote its governance;

- c. Maximising zakat roles in supporting equitable economic development and poverty alleviation;
- d. To open up possibility for cross-sector financial activities such as capital market, banking sector, takaful, and awqaf management.

With those desired objectives, the area of regulatory framework may cover:

- a. Zakat operations, i.e collection, distribution, optimisation;
- b. Zakat supporting functions, i.e IT system, human resources development;
- c. Risk management control;
- d. Supervisory framework;

## 4. Proposed Regulatory Standard of Zakat Management

Zakat institutions have degenerated in many Muslim societies by trying various policies. In order to mitigate the menace of poverty, there is a need to develop standards and guidelines on best practices for zakat management. The Zakat Core Principles are a starting point for the frameworks and standards of zakat-based governance best practices. The Zakat Core Principles is mainly aimed to improve the quality of the zakat systems by identifying such weaknesses in the existing of supervision and regulation.

### 4.1. Zakat Regulations and Basel Core Principles in Comparison

The development of zakat regulations may benefit from current developments that are taking place in other financial sector industries. Thus, the Core Principles on Governance for Zakat Management aim to adapt the existing internationally recognized frameworks of the Basel Core Principles (BCPs). The Basel Core Principles (BCPs) are the minimum standards for sound prudential regulation and supervision of banks and banking systems. The BCPs have already been conducted as a banking quality benchmark in more than 150 countries, so that the BCPs may represent the best role model for assessing the quality of the supervisory practices. By adapting the BCPs, the Zakat Core Principles represent an international standard of high-level principles to achieve and assess Zakat supervisory practices. This section adapts the 29 Basel Core Principles that were last revised in September 2012 (Basel Committee on Banking Supervision, 2012).

**Exhibit 4** shows the comparison between core principles for effective banking supervision to the proposed principles for effective supervision of zakat institutions. There are 18 principles that are generally categorized into two main groups: powers, responsibilities and functions of zakat supervisor are explained in the first group (Principles 1 to 7) whilst prudential regulations and requirements for zakat institutions are given in the second group (Principles 8 to 18).

**Exhibit 4 (a)**  
**Supervisory Powers, Responsibilities and Functions**

Basel Core Principles	Zakat Core Principles
BCP 1 : Responsibilities, objectives and powers	ZCP 1 : Objectives, independence, and powers
BCP 2 : Independence, accountability, resourcing and legal protection for supervisors	
BCP 3 : Cooperation and collaboration	
BCP 4 : Permissible activities	ZCP 2 : Permissible activities
BCP 5 : Licensing criteria	ZCP 3 : Licensing criteria
BCP 6 : Transfer of significant ownership	-
BCP 7 : Major acquisitions	-
BCP 8 : Supervisory approach	ZCP 4 : Zakat supervisory approach
BCP 9 : Supervisory techniques and tools	ZCP 5 : Zakat supervisory techniques and tools
BCP 10 : Supervisory reporting	ZCP 6 : Zakat supervisory reporting
BCP 11 : Corrective and sanctioning powers of supervisors	ZCP 7 : Corrective and sanctioning powers of zakat supervisor
BCP 12 : Consolidated supervision	-
BCP 13 : Home-host relationships	-

Some principles in the Basle Core Principles (BCP) are still relevant to the zakat supervision. The proposed principles for zakat supervision consist of 18 core principles. ZCP-1 combines the BCP 1 – 3 and defines the objectives, independence, and powers of the zakat supervisory body. ZCP-2 and ZCP-3 represents the BCP-4 and BCP-5 on the permissible activities and licensing criteria. BCP-6 and BCP-7 are not relevant to zakat supervision. ZCP-4, ZCP-5, ZCP-6, and ZCP-7 represent BCP-8, BCP-9, BCP-10, and BCP-11 respectively on the supervisory approach, supervisory technique and tools, supervisory reporting, and corrective and sanctioning powers of supervisors. BCP-12 and BCP-13 on consolidated supervision and home-host relationship are not relevant to the zakat supervision.

**Exhibit 4 (b)**  
**Prudential Regulations and Requirements**

Basel Core Principles	Zakat Core Principles
BCP 14 : Corporate governance	ZCP 8 : Good amil governance
BCP 15 : Risk management process	ZCP 9 : Collection management
BCP 16 : Capital adequacy	
BCP 17 : Credit risk	
BCP 18 : Problem assets, provisions and reserves	ZCP 10 : Disbursement management
BCP19 : Concentration risk & large exposure limits	
BCP 20 : Transactions with related parties	ZCP 11 : Country and transfer risks
BCP 21 : Country and transfer risks	
BCP 22 : Market risk	ZCP 12 : Reputation and muzakki loss risk

Basel Core Principles	Zakat Core Principles
BCP 23 : Interest rate risk in the banking book	-
BCP 24 : Liquidity risk	ZCP 13: Disbursement risk
BCP 25 : Operational risk	ZCP 14: Operational risk
BCP 26 : Internal control and audit	ZCP 15: Shari'ah control and internal audit
BCP 27 : Financial reporting and external audit	ZCP 16: Financial reporting and external audit
BCP 28 : Disclosure and transparency	ZCP 17: Disclosure and transparency
BCP 29 : Abuse of financial services	ZCP 18: Abuse of zakat services

ZCP-8 represents BCP-14 on good governance of zakat institutions. ZCP-9 combines the BCP-15, BCP-16, and BCP-17 on risk management process, capital adequacy, and credit risk into one principle i.e. zakat collection management. ZCP-10 combines BCP-18 and BCP-19 on problem assets, provision, and reserves and concentration & large exposure limit into zakat disbursement management. ZCP-11 combines BCP-20 and BCP-21 on transaction with related parties and country and transfer risk into country and transfer risk. ZCP-12 represents BCP-22 on market risk into reputation and muzaki loss risk. BCP-23 on interest risk in the banking book is not relevant. ZCP-13 represents BCP-24 on liquidity risk. ZCP-14 represents BCP-25 on operational risk. ZCP-15 represents BCP-26 on internal control and audit into Shari'ah control and internal audit. ZCP-16, ZCP-17, and ZCP-18 represent BCP-27, BCP-28, BCP-29 on financial reporting and external audit, disclosure and transparency, and abuse of financial services respectively.

#### 4.2. Preconditions for Effective Zakat Supervision

An effective zakat supervisory process cannot be performed without the genuine cooperation between the zakat supervisors and all relevant authorities. There must be adequate systems in place to develop, implement, monitor and enforce supervisory tools and policies on the effective system of zakat supervision. The zakat supervisors should put in place strong external controls and risk management to responds a number of elements or preconditions that have a direct impact on the effectiveness of zakat supervision in practice. There are three preconditions for effective zakat supervision as follows:

- a) A well established framework for zakat policy formulation.  
All parties who are involved and responsible for the overall implementation of the zakat system should be identified on a clear framework for zakat policy formulation. This zakat policy framework is set out on zakat act, laws, regulations, or other arrangements. The framework reflects the need to manage mechanism for effective zakat supervision.
- b) A well developed public infrastructure.  
There are four elements of public infrastructure to support an effective of zakat supervision, namely:
  - (i) comprehensive and appropriate national zakat accounting standards and rules;
  - (ii) a system of independent external audits and accountants;

- (iii) availability of 'amil officers who are competent and professional with transparent technical and Islamic ethical standards;
  - (iv) Availability of regional, economic, and social statistics.
- c) A clear framework for collection and disbursement management. Collection and disbursement activities as the main aspects of zakat management need to be supervised by the relevant authorities. A clear framework for collection and disbursement management help to optimize the function of zakat as a tool of poverty alleviation.
- d) Well-defined supervisory objectives  
In a country where zakat management is carried out by private institutions, the supervisory objectives will cover the area of the Good Corporate Governance (GCG) and management structures with the aims of minimising unnecessary losses from inefficient management practises and mitigating risks arising from zakat management and operations. Meanwhile, in a country where zakat management is carried out by government institutions, supervisory activities are embedded within government institutions.

### 4.3. Proposed Principles for Zakat System

To retain as a flexible, globally, applicable standard, the Zakat Core Principles are formulated by the proportionality concept from a broad range of zakat institutions (from compulsory zakat management system to voluntary zakat management system). The main objective of the Zakat Core Principles is to strengthen a sound supervisory zakat management and a zakat safety net instrument among Muslim countries.

The Zakat Core Principles are the minimum standards to be applied by all zakat supervisions. In implementing compliance with a Principle, this section proposes the assessment criteria for each 18 Principles under a set of "essential criteria" and "additional criteria" for each Principle. Essential criteria are elements that should be present in to assess full compliance with a Zakat Principle. Additional criteria are elements that may be relevant to the countries with advanced zakat system. To achieve best zakat supervisory practices, a country may voluntarily choose to be assessed against the additional criteria, in addition to the essential criteria (Basel Committee on Banking Supervision, 2012).

The proposed zakat principles are further elaborated in this section. The following tables (Exhibit 5) propose the essential and additional criteria for each proposed Principle.

**Exhibit 5 (a)**  
**Zakat Core Principle 1-3**

<b>Zakat Core Principles</b>	<b>Key Words</b>
<b>ZCP - 1</b> <i>Objectives, independence, and powers</i>	Laws, regulation, or other legal framework for zakat supervision is clearly defined to provide each responsible authority with the necessary legal powers and independent rule.
Essential criteria	<ol style="list-style-type: none"> <li>1. The main objective of zakat supervision is to promote the minimum standard for sound regulation and supervision of zakat management system.</li> <li>2. The effective zakat system should have a solid legal foundation in terms of zakat act.</li> <li>3. The governing zakat act is adequate and comprehensively translated into operational regulation.</li> <li>4. The elements of independence and power to regulate have to be clearly mentioned in the articles of zakat act. Zakat funds should be managed independently in accordance with shari'ah rules.</li> <li>5. Zakat act and its operating rules and regulations have to be recognized by other relevant acts and regulations.</li> <li>6. The zakat act should clearly define regulatory and supervisory structures that cover shari'ah rules.</li> <li>7. The zakat supervisor has the power to:               <ol style="list-style-type: none"> <li>a) obtain full access to zakat institutions' Boards, management, staff and records;</li> <li>b) review the overall activities of a zakat institution, both collection and disbursement;</li> <li>c) impose an appropriate corrections, sanctions and revoke the zakat institution's license when a zakat institution is not complying with the rules</li> </ol> </li> </ol>
Additional criteria	<ol style="list-style-type: none"> <li>1. Zakat system has to have a logical and operational relationship with central and local government activities.</li> <li>2. The zakat supervisor has to have sufficient local and cross border cooperation with other regulatory bodies.</li> </ol>
<b>ZCP - 2</b> <i>Permissible Activities</i>	Laws, regulations, or other arrangements clearly define the permissible activities of zakat institutions in accordance with the principles of shari'ah, including the field of zakat collections, zakat disbursement, and other religious charitable funds.
Essential criteria	<ol style="list-style-type: none"> <li>1. Sources of zakatable items must be clearly determined in the zakat act.</li> <li>2. General criteria of zakat collection should be mentioned in the zakat act.</li> <li>3. General criteria of zakat disbursement should be mentioned in the zakat act.</li> <li>4. Zakat supervisor publishes available a current list of licensed zakat institutions that is easily accessible to the public.</li> <li>5. Zakat institutions can also manage infaq, shadaqah and other religious charitable funds that are defined in the zakat act.</li> <li>6. Zakat supervisor publishes available a current list of licensed zakat institutions that is easily accessible to the public.</li> </ol>

Zakat Core Principles	Key Words
Additional criteria	<ol style="list-style-type: none"> <li>1. The method of collection has to have formal permission from the zakat supervisor.</li> <li>2. Methodology to allocate zakat fund, particularly in allocating productive zakat fund, has to get approval from zakat supervisor.</li> <li>3. Zakat institutions may collect Corporate Social Responsibility (CSR) fund that is classified as infaq and shadaqah.</li> </ol>
<b>ZCP - 3</b> <i>Licensing Criteria</i>	The licensing authority has the regulatory power to set criteria for licensing zakat institutions and reject applications that do not meet the criteria.
Essential criteria	<ol style="list-style-type: none"> <li>1. Licensing power is a part of regulatory power that is mentioned clearly in the zakat act.</li> <li>2. Licensing process includes providing licenses to operate the zakat institutions.</li> <li>3. The zakat act identifies the authority responsible for granting and withdrawing a licensed zakat institution and manpower.</li> <li>4. The criteria for licensing zakat institutions are set by the licensing authority.</li> </ol>
Additional criteria	<ol style="list-style-type: none"> <li>1. Selection criteria for the zakat management have to go through an appropriate fit and proper test.</li> </ol>

**Exhibit 5 (b)**  
**Zakat Core Principle 4 - 6**

Zakat Core Principles	Key Words
<b>ZCP - 4</b> <i>Supervisory Approach</i>	The zakat supervisor has a supervision scheme on an integrated basis covering all aspects of the zakat collection and zakat disbursement.
Essential criteria	<ol style="list-style-type: none"> <li>1. The zakat supervisor uses a methodology for determining and assessing the risk of shari'ah issues, internal control environment, and the optimization of zakat management system.</li> <li>2. The zakat supervisor assesses zakat institutions' compliance with shari'ah regulations and other legal requirements.</li> <li>3. The zakat supervisor has a clear framework or process for assuring zakat management activities being fully performed by shari'ah regulations and legal requirements.</li> </ol>
Additional criteria	-
<b>ZCP - 5</b> <i>Supervisory Techniques and Tools</i>	The zakat supervisor uses an appropriate range of techniques and tools to implement the supervisory approach and employs zakat supervisory resources which are subject to adequate validation and verification.
Essential criteria	<ol style="list-style-type: none"> <li>1. The zakat supervisor uses a clear framework of information system and strategic tools to regularly assess the processing, monitoring, and analysis of zakat management system as follows:</li> </ol>



Zakat Core Principles	Key Words
	a) analysis of financial statements and accounts; b) shari'ah compliance analysis; c) collection model analysis; d) disbursement model analysis; e) analysis of good amil governance. 2. The zakat supervisor evaluates the performance of the zakat institutions' internal audit function in identifying strategic areas. 3. The zakat supervisor may use of independent third parties, such as financial auditors. The zakat supervisor attempts appropriate monitoring to check that zakat institutions have addressed supervisory concerns.
Additional criteria	
<b>ZCP – 6</b>	The zakat supervisor collects, reviews, and analyses zakat institutions' performance.
<i>Supervisory Reporting</i>	
Essential criteria	1. The zakat supervisor has the power to require zakat institutions to submit supervisory information on a timely and accurate basis, such as their financial condition. 2. The zakat supervisor provides a clear instruction for periodic reports that clearly describe the zakat accounting guidelines. 3. The zakat supervisor utilizes policies and procedures that determine the validity and integrity of supervision information.
Additional criteria	1. The zakat supervisor uses an integrated IT system to support the reporting system. 2. The zakat supervisor uses the accounting standards and rules that are widely accepted internationally. 3. The zakat supervisor collects mustahik database from all zakat institutions to optimize the effectiveness of disbursement.

**Exhibit 5 (c)****Zakat Core Principle 7-8**

Zakat Core Principles	Key Words
<b>ZCP – 7</b> <i>Corrective and sanctioning power of zakat supervisor</i>	The zakat supervisor has an adequate range of supervisory tools to bring about timely corrective actions, the ability to revoke the license of zakat institutions (only happen in a country who has more than one institution, i.e., decentralized system) and to recommend its revocation.
Essential criteria	1. The zakat supervisor should set an appropriate range of supervisory tools to be used when a zakat institution is not complying with shari'ah laws, regulations, and supervisory actions.

Zakat Core Principles	Key Words
	<ol style="list-style-type: none"> <li>2. The zakat supervisor has a broad range of measurement to take timely corrective actions or to impose sanction expeditiously.</li> <li>3. The zakat supervisor imposes sanctions not only to the zakat institutions but, when and if necessary also to management and/or the Board, or individuals therein.</li> </ol>
Additional criteria	<ol style="list-style-type: none"> <li>1. Zakat act guards against the zakat supervisor unduly delaying appropriate corrective actions.</li> <li>2. The zakat supervisor may use rating assessment to enhance the corrective actions from zakat institutions.</li> </ol>
<b>ZCP – 8</b> <i>Good Amil Governance</i>	The zakat supervisor determines that zakat institutions have robust amil governance's policies and processes covering shari'ah compliance, strategic tools, control environment, zakat management knowledge, and responsibilities of the zakat institutions' Boards.
Essential criteria	<ol style="list-style-type: none"> <li>1. Shari'ah law, regulations, and the zakat supervisor determine that the concept and definition of amil still can be applied in the current zakat institutions. Amil deserve to get the share of zakat by not more than 1/8 or 12.5% of total zakat collected. If the share of zakat is not enough to pay their wage, it can be paid from non-zakat wealth such as shadaqah, infaq, or tax.</li> <li>2. The zakat supervisor provides guidance to zakat institutions on expectations for sound amil governance.</li> <li>3. The zakat supervisor regularly assesses a zakat institution's amil governance policies and practices commensurate with shari'ah regulations and systemic importance.</li> <li>4. The zakat supervisor establishes the amil governance structures and requirements that are appropriate for nominating and appointing such manpower of honesty, trustworthy, upright, and virtuous.</li> <li>5. The zakat supervisor determines that the zakat institution's Board: <ol style="list-style-type: none"> <li>a) approves and actively oversees implementation of the zakat supervisory direction and strategy;</li> <li>b) establishes and communicates Islamic culture and values through code of conduct;</li> <li>c) establishes fit and proper standards in selecting amil officers who have good characters, integrity, and three basic knowledge (zakat collection, zakat disbursement, and financial management);</li> <li>d) establishes conflicts of interest policies and a strong control environment; and</li> <li>e) ensures the effectiveness of amil governance over the zakat institutions' entire management.</li> </ol> </li> <li>6. The zakat supervisor has the power to recommend changes in the composition of the zakat institution's Board if it is proved legally that any individuals are not fulfilling their duties.</li> </ol>

Zakat Core Principles	Key Words
Additional criteria	1. The zakat supervisor maintains plan for succession to improve the quality of amil officers through certification

**Exhibit 5 (d)****Zakat Core Principle 9**

Zakat Core Principles	Key Words
<b>ZCP – 9</b> <i>Collection management</i>	The zakat supervisor determines that zakat institutions have adequate policies and processes for nisabassessment and zakatable assets.
Essential criteria	<ol style="list-style-type: none"> <li>1. Zakat act should designate the institutions that will charges and collects zakat<sup>2</sup></li> <li>2. The zakat supervisor determines the period of zakat collecting immediately (except in time of disaster)</li> <li>3. The zakat supervisor should ensure that zakat institution has made the collection proactively</li> <li>4. The zakat supervisor determines the rate of zakat (nisab) depend on the source of income or the extent of property accumulation in the light of the shari’ah.</li> <li>5. The zakat supervisor determines that zakat institutions have appropriate policies and processes for regularly evaluating the various types of zakatable assets.</li> <li>6. The zakat supervisor determines that zakat institutions’ Board obtains timely and appropriate information on the classification of zakatable assets.</li> <li>7. The zakat supervisor should ensure that zakat institution has made the collection proactively. In order to achieve the primary objective of poverty alleviation, zakat institutions needs to prioritize a larger proportion of zakat fund than other charitable funds.</li> <li>8. The zakat supervisor determines the period of zakat collecting immediately (except in time of disaster).</li> </ol>
Additional criteria	1. It becomes necessary that the zakat supervisor identifies the zakat liability from “new forms of wealth” not known in the early days of Islam, eg the joint-stock company or corporation.

<sup>2</sup> In the period of the Prophet, there had been zakat collecting officers who were directly appointed. The zakat collecting activities already covered almost the whole peninsula. The Prophet had even a dedicated secretary to take care of zakat operation.

**Exhibit 5 (e)**  
**Zakat Core Principle 10**

Zakat Core Principles	Key Words
<b>ZCP - 10</b> <i>Disbursement management</i>	The zakat supervisor determines that zakat institutions have adequate policies and processes to manage zakat funds and distribution system.
Essential criteria	<ol style="list-style-type: none"> <li>1. Shari'ah laws, regulations, or the supervisor require zakat institutions to formulate policies and processes for identifying and managing zakat funds. Zakat funds are an entity separate from government funds and revenues.</li> <li>2. The zakat supervisor determines that zakat fund from the latest collection period must be distributed maximum for 1 year. The disbursement period can be categorized as follows: <ul style="list-style-type: none"> <li>&lt; 3 months : fast</li> <li>3 - 6 months : good</li> <li>6 - 9 months : fair</li> <li>9 - 12 months : slow</li> <li>&gt; 12 months : zalim</li> </ul> </li> <li>3. The zakat supervisor assesses the level of disbursement management by using disbursement-to-collection ratio (DCR). This ratio quantifies the ability of zakat institution to distribute zakat fund by dividing total disbursement by its total collection. The DCR is expressed as a percentage that can be categorized as follows: <ul style="list-style-type: none"> <li>&gt; 90 % : highly effective</li> <li>70 - 89 % : effective</li> <li>50 - 69 % : fairly effective</li> <li>20 - 49 % : below expectation</li> <li>&lt; 20 % : poor - zalim</li> </ul> </li> <li>4. Shari'ah rules, regulations, and the zakat supervisor require zakat institutions to formulate policies and processes to spend zakat for the benefit of (Surah At-Taubah verse 60): <ul style="list-style-type: none"> <li>- the poor (<i>fuqara</i>);</li> <li>- the needy (<i>miskin</i>);</li> <li>- those who are deputed to collect zakat;</li> <li>- those whose hearts are to be reconciled;</li> <li>- freeing the slave;</li> <li>- the indebted;</li> <li>- those on the way of Allah; and</li> <li>- Wayfarer.</li> </ul> </li> <li>5. The zakat supervisor requires that zakat institutions have a procedure to give a priority scale of the eight <i>ashnaf</i>. The poor (<i>fuqara</i>) and the needy (<i>miskin</i>) are the most important groups that must be given the first priority and the largest amount in the distribution of zakat.</li> </ol>

Zakat Core Principles	Key Words
	<p>6. Zakat is distributed based on priority after considering principles of equity, justice, and territorial proximity. The zakat supervisor assesses whether distribution of zakat is adequate within its locality of origin and/or its disbursement beyond it. To solve its respective domestic problem, it should be given priority in securing the right of the poor from the same territorial of collected location.</p> <p>7. The zakat supervisor determines that zakat institutions have policies and processes to prevent persons benefiting from the disbursement arrangements. Shari'ah rules, regulations, and the zakat supervisor set prudent and appropriate requirements to control and constrain large disbursement to a single counterparty or a group of connected counterparties such as by auction. The supervisor also determines that zakat institutions monitor related party disbursement on an ongoing basis.</p>
Additional criteria	<ol style="list-style-type: none"> <li>1. The zakat supervisor obtains and reviews disbursement information on national level to related parties.</li> <li>2. The zakat supervisor determines that zakat institutions have a productive disbursement programs.</li> </ol>

**Exhibit 5 (f)****Zakat Core Principle 11-12**

Zakat Core Principles	Key Words
<b>ZCP - 11</b> <i>Country and transfer risk</i>	The zakat supervisor determines that zakat institutions have adequate policies and processes to control country risk and transfer risk of zakat in their international zakat transfer activities.
Essential criteria	<ol style="list-style-type: none"> <li>1. The zakat supervisor determines policies and processes to identify, measure, evaluate, monitor, report, control, and mitigate country risk and transfer risk. These processes provide a comprehensive view of country and transfer risk exposure, take into account macroeconomic conditions.</li> <li>2. The donor supervisor assesses a scale priority of recipient country through poverty level, calamity impact and the closest territorial from its donor country.</li> <li>3. The donor supervisor limits the range of activities by identifying a clear definition and assessment of the eight <i>ashnaf</i>.</li> <li>4. Donor and recipient supervisors share appropriate information on a timely basis in line with the informal or formal arrangements (such as memorandum of understanding) to enable the exchange of confidential information.</li> </ol>
Additional criteria	<ol style="list-style-type: none"> <li>1. The zakat supervisor, directly or indirectly, cooperates with the relevant foreign zakat supervisors to obtain additional information as needed (eg crisis situations).</li> </ol>

Zakat Core Principles	Key Words
<b>ZCP - 12</b> <i>Reputation and muzaki loss risks</i>	The zakat supervisor determines that zakat institutions have an adequate management framework to handle contagion, reputation, and muzakki loss risks.
Essential criteria	<ol style="list-style-type: none"> <li>1. The zakat supervisor understands the overall structure of the zakat institutions in the wider environment, in particular contagion and reputation risks, may jeopardize the safety and soundness of the zakat management system.</li> <li>2. The zakat supervisor imposes prudential standards to identify, assess, evaluate, monitor, report, control, and mitigate reputation risk.</li> <li>3. The zakat supervisor addresses all major aspects of reputation risk in the national zakat system, including periods when contagion and reputation risks could increase.</li> <li>4. The zakat supervisor requires zakat institutions' strategies, policies and processes for the management of reputation risk to minimize muzakki losses. The zakat supervisor also requires the Board to ensure that these policies and processes are implemented effectively.</li> <li>5. The zakat supervisor requires that zakat institutions have adequate socialization and education programs to enhance the well-informed public about zakat.</li> </ol>
Additional criteria	<ol style="list-style-type: none"> <li>1. The zakat supervisor determines that there is an appropriate incentive to keep existing muzakki and attract new muzakki, such as tax deduction or excellent zakat services.</li> <li>2. The zakat supervisor determines that zakat institutions have established appropriate information technology policies and processes to ease a periodic report to the muzakki.</li> </ol>

**Exhibit 5 (g)****Zakat Core Principle 13-15**

Zakat Core Principles	Key Words
<b>ZCP - 13</b> <i>Disbursement risk</i>	Zakat institutions should be able to mitigate disbursement risks such as financial position sound and misallocation of disbursement activities.
Essential criteria	<ol style="list-style-type: none"> <li>1. The zakat supervisor requires zakat institutions have established disbursement strategies, policies and processes to identify, assess, monitor and manage disbursement risks.</li> <li>2. To mitigate misallocation of disbursement, the zakat supervisor determines that zakat institutions have a comprehensive assessment for each <i>ashnaf</i>.</li> </ol>

Zakat Core Principles	Key Words
	<p>3. The zakat institutions should have proper financial planning, recording and management to prevent mismatch allocation of fund distribution.</p> <p>4. The financial management is up-dated in a frequent manner so that the management has an accurate figure of financial position to meet all financial obligations timely.</p> <p>The zakat supervisor determines that the Board and management obtain, understand, and review sufficient information on how the level of risk relates to financial position and disbursement activities.</p>
Additional criteria	<p>1. To minimize misallocation problems, zakat institutions may have the measurement of <i>had al-kifayah</i> minimum adequacy for the needs of individual rights.</p> <p>2. Zakat institutions may further enhance a sound disbursement risk management through collaboration with other financial sectors such as Islamic banking and awqaf sector.</p>
<b>ZCP – 14</b> <i>Operational risk</i>	The zakat supervisor determines that zakat institutions should have proper operational risk management to minimize potential fraudulent practices, anticipation towards system breakdown and any other potential disturbance.
Essential criteria	<p>1. The management unit should have proper methodology to identify, measure, mitigate and monitor the operational risk.</p> <p>2. Zakat institutions have an appropriate internal process for covering potential fraud, technical failure of the IT system, and any other factors that may disturb the zakat institutions from their daily operations.</p> <p>3. Laws, regulations, or the zakat supervisor require the zakat institutions must be equipped with good governance structure to ensure that responsibility and accountability are in place.</p> <p>4. Zakat institutions should have dedicated unit to take care of operational risk.</p>
Additional criteria	–
<b>ZCP – 15</b> <i>Shari’ah control and internal audit</i>	The zakat supervisor determines zakat institutions to have appropriate shari’ah control and internal audit frameworks to establish and maintain a properly controlled operating environment in the light of shari’ah.
Essential criteria	<p>1. Shari’ah laws, regulations or the zakat supervisor require zakat institutions to have internal control frameworks that are adequate to establish:</p> <ul style="list-style-type: none"> <li>a) organizational structure;</li> <li>b) zakat accounting policies and processes; and</li> <li>c) segregation of zakat funds and other charitable funds.</li> </ul> <p>2. The zakat supervisor determines that the internal audit function:</p> <ul style="list-style-type: none"> <li>a) has sufficient and qualified resources that are suitably trained, have relevant experiences and have sufficient authority to perform their role;</li> </ul>

Zakat Core Principles	Key Words
	<p>b) is well informed for every changes made by the Boards;  c) has full access to any members of staff and data that are relevant with its duties; and  d) has an regular audit plan.</p> <p>3. The zakat supervisor determines that zakat institutions have an adequately staffed, permanent, independent, shari'ah control n internal audit function charged with:</p> <p>a) assessing whether existing policies, processes, shari'ah control and internal control are effective, appropriate and remain sufficient for zakat institution's performances; and ensuring that policies and processes are complied with.</p>
Additional criteria	-

**Exhibit 5 (h)****Zakat Core Principle 16-18**

Zakat Core Principles	Key Words
<b>ZCP - 16</b> <i>Financial reporting and external audit</i>	The zakat supervisor determines that zakat institutions maintain reliable records of financial statements, annual publication and external audit function.
Essential criteria	<ol style="list-style-type: none"> <li>1. The zakat supervisor holds the zakat institution's Board and management responsible for: <ol style="list-style-type: none"> <li>a) ensuring that financial statement are prepared in accordance with accounting practices that are widely accepted nationally; and</li> <li>b) ensuring that the financial statement issued annually to the public bear an independence external auditor's opinion.</li> </ol> </li> <li>2. Laws, regulations, or the zakat supervisor has the power to establish the standard and scope of work for external audits that cover areas such as the asset valuations and the percentage of disbursement effectiveness.</li> <li>3. The zakat supervisor has the power to reject and rescind an unprofessional external audit.</li> </ol>
Additional criteria	1. The zakat supervisor has the power to access external auditors' working paper.
<b>ZCP - 17</b> <i>Disclosure and transparency</i>	The zakat supervisor determines that zakat institutions regularly publish consolidated information that is easily accessible and fairly reflects their financial condition and performance.
Essential criteria	<ol style="list-style-type: none"> <li>1. Laws, regulations or the zakat supervisor require zakat institutions to publish periodic disclosures of information on a consolidated.</li> <li>2. The zakat supervisor determines that the required disclosures are both qualitative and quantitative information including financial performance, disbursement activities, accounting policies, management, and amil governance.</li> </ol>



Zakat Core Principles	Key Words
	3. The zakat supervisor or another government agency effectively reviews and enforces compliance with disclosure standards.
Additional criteria	–
<b>ZCP – 18</b> <i>Abuse of zakat services</i>	The zakat supervisor determines that zakat institutions have appropriate policies and processes to promote Islamic ethics and professional standards and to prevent criminal activities.
Essential criteria	<ol style="list-style-type: none"> <li>1. Zakat act establishes the duties, responsibilities, and powers of the zakat supervisor related to the zakat supervision of internal controls and regulations regarding criminal activities, such as terrorism, money laundering, and corruption.</li> <li>2. The zakat supervisor determines that zakat institutions have adequate policies and processes that promote Islamic ethics and professional standards and prevent the zakat institutions from being used, intentionally or unintentionally, for criminal activities.</li> <li>3. The zakat supervisor report to the financial intelligence unit or relevant authorities about such suspicious activities and incidents in order to keep the safety, soundness or reputation of the zakat institutions.</li> <li>4. The zakat supervisor determines policies and processes that are integrated and appropriate to identify, assess, monitor, manage and mitigate risks of money laundering and the financing of terrorism with respect to countries, regions, disbursement products, and zakat services.</li> <li>5. The zakat supervisor determines that zakat institutions have sufficient controls and systems to identify, prevent, and report potential abuses of zakat services, including money laundering and the financing of terrorism.</li> <li>6. The zakat supervisor has power to take appropriate action against a zakat institution that does not comply with its obligation regarding criminal activities.</li> </ol>
Additional criteria	1. The zakat supervisor, directly or indirectly, cooperates with the relevant domestic and foreign financial sector supervisory authorities.

## **5. Conclusion and Recommendation**

### **4.1. Conclusion**

1. Zakat system can play very important role in supporting sustainable economic development and in facilitating better financial inclusion. Collaboration with other financial sector such as Islamic banking and awqaf sector could further enhance its capacity to reach the low-income society. Conceptually, the development of zakat system can be considered complementary to the government programs of poverty alleviation. A certain level of synchronization with the government program is desirable.
2. However, current regulatory framework for zakat sector must be improved so that the operation of zakat system can be conducted in a more effective way. The development of zakat regulatory framework can somehow benefit from the current development of conventional financial system. Certain elements of sound financial regulation are still relevant to the zakat regulatory framework.
3. At the level of core principles, zakat system can use Basle Core Principles for banking supervision as the reference point for initial development. Some modifications to the BCP include identification of common regulatory items, putting aside the non-relevant items, and developing new items that do not exist in the BCP.

### **4.2. Recommendation**

1. Further discussion needs to take place to better accommodate certain characteristics in certain countries which do not exist in others.
2. Like other international standards, Zakat Core Principles is proposed to help countries in setting-up proper regulatory framework at the principle and discretionary basis.

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