



Consultative Document

**Core Principles for Effective
Zakat Supervision**

May 2016

Acknowledgement

This paper was dedicatedly written to serve as a consultative document for Zakat Core Principles. The document was prepared jointly by the National Board of Zakat of the Republic of Indonesia (BAZNAS) and the Central Bank of the Republic of Indonesia in collaboration with representatives of selected countries that operate Zakat system and observers.

This document does not represent the stance of Bank Indonesia or BAZNAS. All opinions and any mistakes found are of the authors.

BAZNAS

Irfan Syauqi Beik, PhD
Hudzaifah Hanum

Bank Indonesia

Dadang Muljawan, PhD
Diana Yumanita, MSc
Astrid Fiona, MSc
Jhordy Kashoogie Nazar, MSc

INTERNATIONAL WORKING GROUP ON ZAKAT CORE PRINCIPLES

Members¹

Prof. Dr. Nasim Shah Shirazi	Islamic Research and Training Institute, Islamic Development Bank
Dr. Mohammed Obaidullah	Islamic Research and Training Institute, Islamic Development Bank
Mr. Teten Kustiawan	National Board of Zakat of the Republic of Indonesia
Mrs. Hermin Rachim	National Board of Zakat of the Republic of Indonesia
Mr. Amran Hazali	Pusat Pungutan Zakat Malaysia
Tuan Haji Azrin Abdul Manan	Pusat Pungutan Zakat Malaysia
Hj. Arrifa Binti Ariffin	Lembaga Zakat Selangor
Dr. Saleh Ali Alawaji	Department of Zakat and Income Tax, Saudi Arabia
Dr. Syed Zafar Mahmood	Zakat Foundation of India
Dr. Shamsiah Abdul Karim	Asset Development Islamic Religious Council of Singapore
Dr. G.M. Arif	Pakistan Institute of Development Economics
Mr. Elnur Salihovic	Islamic Community of Bosnia
Mr. M Hoosen Essof	South Africa National Zakah Fund
Mr. Ariff Shaikh	South Africa National Zakah Fund
Mr. Resat Baser	IHH Humanitarian Relief Foundation, Turkey
Mr. Mohammed Abdel Raziq	The Zakat Chamber of Sudan

¹ The names appear in the list of IWG-ZCP had participated at least in one round of the total 4 rounds of working groups.

INTERNATIONAL WORKING GROUP ON ZAKAT CORE PRINCIPLES

Observers²

Prof. Dr. Abdul Ghafar Ismail	Islamic Research and Training Institute, Islamic Development Bank
Prof. Dr. M. Aslam Haneef	International Islamic University Malaysia (IIUM)
Dr. Mustafa Omar (Uganda)	International Islamic University Malaysia (IIUM)
Aswin Januar Syaf	YARSI
Dr Abd Halim Mohd Noor	Institute Kajian Zakat Malaysia
Assoc Prof. Dr. Ahmad Zaki Hj Abd latiff	Institute Kajian Zakat Malaysia
Nasirwan	Islamic Banking Department - OJK
Mr. Waleed Alatabani	World Bank
Prof. Dr. K.H. Muhammad Tholhah Hasan	Indonesian Waqf Board (BWI)
Prof. Dr.Ir. Lilik Sutiarto, M.Eng	Gadjah Mada University, Indonesia
Dr. Raditya Sukmana	Airlangga University, Indonesia
Dian Maysita Telaga, PhD	Padjajaran University, Indonesia
Dr. Ahmad Juwaini	World Zakat Forum
Dr. Sutan Emir Hidayat	University College of Bahrain
Prof. Magda Ismail Abdel Mohsin Elsayedali	INCEIF

² The appointment of the observers were based on the technical capabilities of particular persons. The contribution was made in terms of inputs to the working group.

Table of Contents

I. Foreword to Review

- Background
- Objectives
- Methodology
- Regulatory Aspects of Zakat
 - General Activities of Zakat Management
 - Institutional Foundation
 - Zakat Administers Qualifications
 - Supporting Infrastructures
- General Regulatory Framework for Zakat Management
- Zakat Regulations and Basel Core Principles in Comparison
- Preconditions for Effective Zakat Supervision

II. Assessment Methodology

- Use of Methodology
- Assessment of Compliance
- Practical Considerations in Conducting an Assessment

III. Proposed Core Principles with Its Criteria for Compliance Assessment

- Legal Foundation: ZCP 1 – 3
- Supervisory Approach: ZCP 4 – 6
- Zakat Governance: ZCP 7 – 8
- Intermediary Function: ZCP 9 – 10
- Risk Management: ZCP 11 – 14
- Shari’ah Governance: ZCP 15 – 18

Glossary

Shari'ah	Divine guidance as given by the Holy Qur'an and the Sunnah of the Prophet Muhammad (PBUH) and embodies all aspects of the Islamic faith, including beliefs and practice.
Zakat	An obligatory contribution or tax which is prescribed by Islam on all Muslim persons having wealth above an exemption limit at a rate fixed by the Shari'ah.
Ijtihad	Effort, exertion, diligence, independent or innovative legal reasoning or interpretation (by qualified Islamic legal scholars) to formulate a ruling on a given issue on the basis of evidence found in Islamic sources.
Nisab	A minimum amount of wealth which determines the zakatability of persons.
Haul	The completion period of zakat assets.
Ashnaf	Eight eligible zakat recipient categories that have been determined by Shari'ah.
Masakeen	These are people who do not have anything, and who are in need of asking others for food, clothing and shelter.
Fuqaraa	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	Those 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.
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.

I. Foreword to Review

Background

1. 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.
2. 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.
3. 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.
4. Zakat system has started to re-emerge in some Muslim populated countries. Some of them have already had a well-design operating guidelines and regulations. However, in general, the development of Zakat system is still in 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. Good governance, strong legal foundation and good management are among the most important aspects that the Zakat system can learn from. 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.

Objectives

5. The Zakat Core Principles are formulized to set minimum regulatory requirements so that the operations zakat mobilization can be effectively conducted. The document contains 2 main objectives as follows:
 - (i) Providing a brief description about the foundation of zakat operations used to set the Zakat Core Principles.
 - (ii) The Zakat Core Principles provides all regulatory aspects relating to the Zakat operations that promote effective Zakat operations.

Methodology

6. The structure of the Zakat Core Principles uses the contemporary structure of financial regulations i.e. the international banking standards that has been internationally accepted with necessary adjustments in certain aspects representing Zakat operations that do not exist in the conventional system. 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.

Regulatory Aspects of Zakat

General Activities of Zakat Management

7. Zakat being 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.
8. 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 wealth 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.
9. There are four aspects that has to be observed for zakat collection in adherence to Shari'ah principles, which are as follows:
 - 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 (pbuh) 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). This ownership may fall under corporation or company according to the prevailing law globally. Hence, potential zakat payer is not only individual but also corporation. This corporation is termed as shaksiyah 'itibariyyah or shakhsiyah hukmiyyah, i.e. legal entity which is considered as man.

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 'led.

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.

10. While for disbursement and allocation program, there are 3 aspects that should be observed under the purview of Shari'ah principles, which are as follows:

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 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. The disbursement program is divided into consumptive-based program and productive -based program. The former aims to provide short term basic needs of the mustahik while the latter attempts to empower the mustahik so that they will sustainable sources of income in the long term. The assessment of consumptive-based program is based on its disbursement speed, which is as follows:

- (i) < 3 months: fast – a zakat institution has already had an effective program and clear targets for consumptive-based programs so that zakat collected may reach the recipients immediately.

- (ii) 3 - 6 months: good – a zakat institution has an effective program and fairly clear targets for consumptive-based programs.
- (iii) 6 - 9 months: fair – a zakat institution has a fairly effective consumptive-based programs and targets
- (iv) 9 - 12 months: slow – the consumptive-based programs of a zakat institution is not quite effective
- (v) > 12 months: extremely slow – the consumptive-based programs of a zakat institution is ineffective or even inexistent.

As for productive-based program, the disbursement speed is assessed based on the following criteria:

- (i) < 6 months: fast – a zakat institution has already had an effective program and clear targets for productive-based programs so that zakat collected may reach the recipients immediately.
- (ii) 6 - 12 months: good – a zakat institution has an effective productive-based programs and fairly clear targets for disbursement.
- (iii) >12 months: fair – a zakat institution has a fairly effective productive-based programs and targets

The zakat supervisor assesses the level of disbursement management by using allocation-to-collection ratio (ACR). 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:

- (i) ≥ 90 % : Highly effective
- (ii) 70 – 89 % : Effective
- (iii) 50 – 69 % : Fairly effective
- (iv) 20 – 49 % : Below expectation
- (v) < 20 % : Ineffective

Institutional Foundation

11. "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 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)
12. 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:
 - (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.

13. 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.

Zakat Administers Qualifications

14. The selection criteria for the zakat administers 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 administers, however, these persons also need to understand of their Shari'ah responsibility in managing the zakat.
15. '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 are as follows:
 - 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 descendants of the Prophet Muhammad's family, since they are the exemptions of zakat recipients.
16. 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.

Supporting Infrastructures

17. 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.

Reporting system

18. 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, and 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.

19. 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.

Risk management system

20. 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.
 - (i) Disbursement risk: A sound disbursement risk management oversees the financial position sound 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.
 - (ii) 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 including shariah incompliant aspect. In order to minimize potential fraud and potential shariah violation, the zakat institutions should be equipped with good governance structure to assure that responsibility and accountability are in place.
 - (iii) 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.

General Regulatory Framework for Zakat Management

21. 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.

Supervisory structure

22. 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.

Regulatory Framework

23. The regulations for zakat institutions cover all the operational aspects of the zakat institutions comprehensively. Those may cover the entry-exit criteria and mechanism, human resources, sound management process of zakat institutions, financial indicators and limits, risk management, and mutual recognition to other types of financial institutions.

Zakat Regulations and Basel Core Principles in Comparison

24. 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 1 (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	-

25. **Exhibit 1** 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).

26. 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 1 (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
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

27. 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.

Preconditions for Effective Zakat Supervision

28. 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:
- (i) 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.
 - (ii) A well-developed public infrastructure.
There are four elements of public infrastructure to support an effective of zakat supervision, namely:
 - a. comprehensive and appropriate national zakat accounting standards and rules;
 - b. a system of independent external audits and accountants;
 - c. availability of 'amil officers who are competent and professional with transparent technical and Islamic ethical standards;
 - d. Availability of regional, economic, and social statistics.
 - (iii) 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.

II. Assessment Methodology

29. The Core Principles are mainly intended to help countries assess the quality of their zakat system and to provide input into their reform agenda. An assessment of the current situation of a country's compliance with the Core Principles can be considered a useful tool in a country's implementation of an effective system of zakat supervision. In order to achieve objectivity and comparability in the different country assessments of compliance with the core principles, supervisors and assessors should refer to this assessment methodology, which does not eliminate the need for both parties to use their judgment in assessing compliance. Such an assessment should identify weaknesses in the existing system of supervision and regulation, and form a basis for remedial measures by government authorities and zakat supervisors.
30. The methodology adapts from the 29 Basel Core Principles that were last revised in September 2012 (Basel Committee on Banking Supervision, 2012). All those principles have both components of essential criteria and additional criteria with the objective of compliance assessment towards zakat regulatory framework.

Use of the Methodology

31. The methodology can be used in multiple contexts: (i) self-assessment performed by zakat supervisory authorities themselves; (ii) Islamic Research and Training Institutes – Islamic Development Bank (IRTI – IDB) and World Bank assessments of the quality of supervisory systems, for example in the context of Islamic Financial Sector Assessment Program (iFSAP); (iii) reviews conducted by private third parties such as consulting firms; or (iv) peer review conducted, for instance, within regional groupings of zakat supervisory authorities.
32. Whatever the context, the following factors are crucial:
 - In order to achieve full objectivity, compliance with the Core Principles is best assessed by suitably qualified external parties consisting of two individuals with strong supervisory backgrounds who bring varied perspectives so as to provide checks and balances; however, experience has shown that a recent self-assessment is a highly useful input to an outside party assessment.
 - A fair assessment of the zakat institutions supervisory process cannot be performed without the genuine cooperation of all relevant authorities.
 - The process of assessing each of the 18 Core Principles requires a judgmental weighing of numerous elements that only qualified assessors with practical, relevant experience can provide.
 - The assessment requires some legal and Good Corporate Governance (GCG) expertise in the interpretation of compliance with the Core Principles; these legal and GCG interpretations must be in relation to the legislative and accounting structure of the relevant country.
 - They may also require the advice of additional legal and GCG, which can be sought subsequent to the on-site assessment.
 - The assessment must be comprehensive and in sufficient depth to allow a judgment on whether criteria are fulfilled in practice, not just in theory. Laws and regulations need to be sufficient in scope and depth, and be effectively enforced and complied with. Their existence alone does not provide enough indication that the criteria are met.

Assessment of Compliance

33. The primary objective of an assessment should be the identification of the nature and extent of any weaknesses in the zakat institutions supervisory system and compliance with individual Core Principles. While the process of implementing the Core Principles starts with the assessment of compliance, assessment is a means to an end, not an objective in itself. Instead, the assessment will allow the supervisory authority (and in some instances the government) to initiate a strategy to improve the zakat institutions supervisory system, as necessary.
34. To assess compliance with a Principle, this methodology proposes a set of essential and additional assessment criteria for each Principle. By default, for the purposes of grading, the essential criteria are the only elements on which to gauge full compliance with a Core Principle. The additional criteria are suggested best practices which countries having advanced the zakat institutions should aim for. Going forward, countries will have the following three assessment options:
- (i) Unless the country explicitly opts for any other option, compliance with the Core Principles will be assessed and graded only with reference to the essential criteria;
 - (ii) A country may voluntarily choose to be assessed against the additional criteria, in order to identify areas in which it could enhance its regulation and supervision further and benefit from assessors' commentary on how it could be achieved. However, compliance with the Core Principles will still be graded only with reference to the essential criteria; or
 - (iii) To accommodate countries which further seek to attain best supervisory practices, a country may voluntarily choose to be assessed and graded against the additional criteria, in addition to the essential criteria.
35. For assessments of the Core Principles by external parties, the following four grade scale will be used: compliant, largely compliant, materially non-compliant, and noncompliant. A "not applicable" grading can be used under certain circumstances as described in paragraph 36.
36. Brief description of grading and their applicability:
- (i). **Compliant** – A country will be considered compliant with a Principle when all essential criteria applicable for this country are met without any significant deficiencies. There may be instances, of course, where a country can demonstrate that the Principle has been achieved by other means. Conversely, due to the specific conditions in individual countries, the essential criteria may not always be sufficient to achieve the objective of the Principle, and therefore other measures may also be needed in order for the aspect of the zakat institutions supervision addressed by the Principle to be considered effective.
 - (ii) **Largely compliant** – A country will be considered largely compliant with a Principle whenever only minor shortcomings are observed which do not raise any concerns about the authority's ability and clear intent to achieve full compliance with the Principle within a prescribed period of time. The assessment "largely compliant" can be used when the system does not meet all essential criteria, but the overall effectiveness is sufficiently good, and no material risks are left unaddressed.
 - (iii). **Materially non-compliant** – A country will be considered materially non-compliant with a Principle whenever there are severe shortcomings, despite the existence of the Principle, several essential criteria are not complied with or supervision is manifestly ineffective.

- (iv). **Non-compliant** – A country will be considered materially non-compliant with a Principle whenever there are severe shortcomings, despite the existence of the Principle, all essential criteria are not complied with or supervision is manifestly ineffective.
37. In addition, a Principle will be considered not applicable when, in the view of the assessor, the Principle does not apply given the structural, legal and institutional features of a country. In some instances countries have argued that in the case of certain embryonic or immaterial the zakat institutions activities, which were not being supervised, an assessment of “not applicable” should have been given, rather than “non-compliant”. This is an issue for judgment by the assessor, although activities which are relatively insignificant at the time of assessment may later assume greater importance and authorities need to be aware of, and prepared for, such developments. The supervisory system should permit such activities to be monitored, even if no regulation or supervision is considered immediately necessary. “Not applicable” would be an appropriate assessment if the supervisors are aware of the phenomenon, and would be capable of taking action, but there is realistically no chance that the activities will grow sufficiently in volume to pose a risk.
38. Grading is not an exact science and the Core Principles can be met in different ways. The assessment criteria should not be seen as a checklist approach to compliance but as a qualitative exercise. Compliance with some criteria may be more critical for effectiveness of supervision, depending on the situation and circumstances in a given jurisdiction. Hence, the number of criteria complied with is not always an indication of the overall compliance rating for any given Principle. Emphasis should be placed on the commentary that should accompany each Principle grading, rather than on the grading itself. The primary goal of the exercise is not to apply a “grade” but rather to focus authorities on areas needing attention in order to set the stage for improvements and develop an action plan that prioritises the improvements needed to achieve full compliance with the Core Principles.
39. The assessment should also include the assessors’ opinion on how weaknesses in the preconditions for effective zakat institutions supervision, hinder effective supervision and how effectively supervisory measures mitigate these weaknesses. This opinion should be qualitative rather than providing any kind of graded assessment. Recommendations with regard to the preconditions should not be part of the action plan associated with the Core Principles assessment, but should be included for instance in other general recommendations for strengthening the environment of financial sector supervision.

Practical Considerations in Conducting an Assessment

40. While the Committee does not have a specific role in setting out detailed guideline on the preparation and presentation of assessment reports, it believes there are a few considerations that assessors should take into account when conducting an assessment and preparing the assessment report.
41. First, when conducting an assessment, the assessor must have free access to a range of information and interested parties. The required information may include not only published information, such as the relevant laws, regulations and policies, but also more sensitive information, such as any self-assessments, and operational guidelines for supervisors. This information should be provided as long as it does not violate legal requirements for supervisors to hold such information confidential. Experience from assessments has shown that secrecy issues can often be solved through ad hoc arrangements between the assessor

and the assessed authority. The assessor will need to meet with a range of individuals and organisations, including the zakat supervisory authorities, any relevant government ministries, zakat related associations, auditors and other financial sector participants. Special note should be made of instances when any required information is not provided, as well as of what impact this might have on the accuracy of the assessment.

42. Second, the assessment of compliance with each Core Principle requires the evaluation of a chain of related requirements which, depending on the Principle, may encompass law, prudential regulation, supervisory guidelines, on-site examinations and offsite analysis, supervisory reporting and public disclosures, and evidence of enforcement or non-enforcement. Further, the assessment must ensure that the requirements are put into practice. This also requires assessing whether the supervisory authority has the necessary operational autonomy, skills, resources and commitment to implement the Core Principles.
43. Third, assessments should not focus solely on deficiencies but should also highlight specific achievements. This approach will provide a better picture of the effectiveness of zakat institutions supervision.
44. Fourth, the development of cross-border zakat funds transfer leads to increased complications when conducting Core Principles assessments. Improved cooperation and information sharing between home and host country supervisors is of central importance and part of assessment considerations in ZCP. The assessor must therefore determine that such cooperation and information sharing actually takes place to the extent needed.

III. Proposed Regulatory Standard of Zakat Management

Proposed Principles for Effective Zakat System

45. 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.
46. 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).
47. The Zakat Core Principles has six dimensions as presented in **Exhibit 2** below to be observed by zakat supervisory authorities and zakat institutions.

Exhibit 2

Six Major Areas of Zakat Core Principles

No.	Dimensions	ZCP
1	Legal Foundations	ZCP 1 – ZCP 3
2	Zakat Supervision	ZCP 4 – ZCP 6
3	Zakat Governance	ZCP 7 – ZCP 8
4	Intermediary Function	ZCP 9 – ZCP 10
5	Risk Management	ZCP 11 – ZCP 14
6	Shari’ah Governance	ZCP 15 – ZCP 18

48. The proposed zakat core principles with six dimensions are further elaborated in this section. The following tables (Exhibit 3a – 3r) propose the essential and additional criteria for each proposed Principle.

Legal Foundations

49. To lay down legal foundations is quintessential for long – run survival of zakat institutions in respective jurisdictions. The strength of legal foundations is dependent upon the stage of development of zakat institutions operating in each country. Due to variety of stage development of zakat institutions in Muslim countries, setting core principles on legal foundations is important. In that respect, ZCP 1 – 3 aims at defining laws and regulation framework set by relevant zakat authorities for zakat institutions activities.

ZCP – 1: Objectives, Independence, and Powers

50. Legal certainty is important to ensure that the regulation is not subject to abuse and possible regulatory downgrades within each respective legal jurisdiction. The presence of legal and regulatory framework set by zakat supervision is important for the objective of legal basis foundation for zakat institution to operationalise zakat collection and disbursement. Hence, laws, regulation, or other legal acts for zakat supervision outlined in ZCP 1 has to be clearly defined to provide each responsible authority with the necessary legal powers and independent rule. In order to set proper laws and regulation framework for zakat institution, there are 8 essential criteria and 3 additional criteria to be observed presented in **Exhibit 3(a)** below:

Exhibit 3 (a)

Zakat Core Principle 1

Zakat Core Principles	Key Words
ZCP - 1 <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"> 1. The main objective of zakat supervision is to promote the minimum standard for sound regulation and supervision of zakat management system. 2. The effective zakat system should have a solid legal foundation in terms of zakat act. 3. The ruling zakat act is adequate and comprehensively translated into operational regulation. 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. 5. Zakat act and its operating rules and regulations have to be recognized by other relevant acts and regulations.

	<ol style="list-style-type: none"> 6. The zakat act should clearly define regulatory and supervisory structures that cover shari'ah rules. 7. The zakat supervisor has the power to: <ol style="list-style-type: none"> a) get full access to zakat institutions' Boards, management, staff and records; b) review the overall activities of a zakat institution, both collection and disbursement; c) impose an appropriate corrections, sanctions and revoke the zakat institution's license when a zakat institution is not complying with the rules 8. In case for minority Muslim country, zakat institutions should comply with prevailing local regulation and legal Islamic council, such as Charity Act or other relevant rules and regulations in the absence of zakat supervisor.
Additional criteria	<ol style="list-style-type: none"> 1. Zakat system has to have a logical and operational relationship with central and local government activities. 2. The zakat supervisor has to have sufficient local and cross border cooperation with other regulatory bodies. 3. In case for minority Muslim country, zakat institutions should cooperate with local government and charity organization for humanitarian purposes.

ZCP – 2: Permissible Activities

51. As zakat institutions operate within the purview of shari'ah principles, permissible activities are definite element for conducting zakat supervision. Due to that reason, permissible activities element is crucial to be defined and incorporated in laws, regulations, or other legal acts in respective country jurisdiction. Failure to do so, zakat funds will not be protected from weaponry, terrorism, and any illegal activities that violate shari'ah principles. Therefore, as stated in the **Exhibit 3(b)** below, there are 6 essential criteria and 3 additional criteria of ZCP 2 to be observed.

Exhibit 3 (b) Zakat Core Principle 2

Zakat Core Principles	Key Words
ZCP - 2 <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"> 1. Sources of zakatable items must be clearly determined in the zakat act. 2. General criteria of zakat collection should be mentioned in the zakat act. 3. General criteria of zakat disbursement should be mentioned in the zakat act. 4. Zakat supervisor publishes available a current list of licensed zakat institutions that is easily accessible to the public. 5. Zakat institutions can also manage infaq, shadaqah and other religious charitable funds that are defined in the zakat act. 6. Zakat supervisor publishes available a current list of licensed zakat institutions that is easily accessible to the public.
Additional criteria	<ol style="list-style-type: none"> 1. The method of collection has to have formal permission from the zakat supervisor. 2. Methodology to allocate zakat fund, particularly in allocating productive zakat fund, has to get approval from zakat supervisor. 3. Zakat institutions may collect Corporate Social Responsibility (CSR) fund under classification of infaq. 4. In case for minority Muslim country, determination of sources of zakatable items and principles of zakat collection and disbursement should be supervised by legal Islamic council and or <i>fatawa</i> council.

ZCP – 3: Licensing Criteria

52. Apart from permissible activities outlined in ZCP 2, licensing criteria is another important aspect to be defined and incorporated in laws, regulations, or other legal acts in respective country jurisdiction. The power to set licensing criteria belongs to the zakat supervisory authorities to preserve the authenticity of zakat institutions and set the parameter to operationalise zakat funds with the adherence to local regulatory and legal frameworks of zakat governance. As presented in **Exhibit 3(c)** below, there are 4 essential criteria and 1 additional criteria as the guidance for the zakat supervisory authorities in licensing activity.

Exhibit 3 (c)
Zakat Core Principle 3

Zakat Core Principles	Key Words
ZCP – 3 <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"> 1. Licensing power is a part of regulatory power that is mentioned clearly in the zakat act. 2. Licensing process includes providing licenses to operate the zakat institutions. 3. The zakat act identifies the authority responsible for granting and withdrawing a licensed zakat institution and manpower. 4. The criteria for licensing zakat institutions are set by the licensing authority. 5. The licensing power and the licensing criteria are set by the legal Islamic council or Islamic local community in the case of Muslim minority country in accordance to local prevailing law.
Additional criteria	<ol style="list-style-type: none"> 1. Selection criteria for the zakat management have to go through an appropriate fit and proper test. 2. In the absence of national law regulating zakat, selection criteria and procedure for the zakat management should be clearly regulated in the constitution of zakat organization.

Zakat Supervision

53. Zakat supervision has not been well developed in Muslim countries. Due to that concern, ZCP 4 – ZCP 6 are deemed important to be observed by zakat supervisory authorities in order to have sound zakat institutions. Hence, ZCP 4 – ZCP 6 deliberate the dimension of supervisory aspects of zakat supervisory institutions that cover supervisory approach, techniques and tools, and reporting.

ZCP – 4: Supervisory Approach

54. Supervisory approach determines the direction of zakat supervisory authorities to supervise zakat institutions in a correct manner. In general, there is a variety of supervisory approach. ZCP 4 is guidance for zakat supervisory authorities to conduct zakat supervision. As presented in **Exhibit 3 (d)** below, ZCP 4 has 3 essential criteria to regulate ideal supervisory approach tailored with domestic shari’ah regulations and legal requirements. With the presence of ZCP 4, zakat supervisory authorities have clear mandates on how to supervise zakat institutions in compliance to regulatory and legal frameworks.

Exhibit 3 (d)
Zakat Core Principle 4

Zakat Core Principles	Key Words
ZCP – 4 <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"> 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. 2. The zakat supervisor assesses zakat institutions’ compliance with shari’ah regulations and other legal requirements. 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. 4. In the absence of national law regulating zakat, supervision should be conducted by legal Islamic council or Islamic local community or other independent legal entity as per the local law
Additional criteria	–

ZCP – 5: Supervisory Techniques and Tools

55. ZCP 5 aims at recommending possible techniques and tools for zakat supervisory authorities, which are absence currently in supervising zakat institutions. As outlined in **Exhibit (e)**, there are 4 essential criteria for zakat supervisory authorities to develop supervisory techniques and tools.

Exhibit 3 (e)
Zakat Core Principle 5

Zakat Core Principles	Key Words
ZCP – 5 <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"> 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: <ol style="list-style-type: none"> 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. 4. The zakat supervisor attempts appropriate monitoring to check that zakat institutions have addressed supervisory concerns. 5. In the absence of national law regulating zakat, the legal Islamic council or Islamic local community, other independent third parties, such as financial auditors, may be used to assess the performance of zakat institutions in terms of financial and managerial accountability and shariah compliance aspect.

ZCP – 6: Supervisory Reporting

56. To supervise zakat institutions, in the absence of supervisory reporting is incomplete for zakat supervisory authorities for conducting zakat supervision. In that respect, ZCP 6 has 3 essential

criteria and 3 additional criteria as portrayed in **Exhibit 3 (f)** to be observed by zakat supervisory authorities.

Exhibit 3 (f)

Zakat Core Principle 6

Zakat Core Principles	Key Words
ZCP – 6 <i>Supervisory Reporting</i>	The zakat supervisor collects, reviews, and analyses zakat institutions' performance.
Essential criteria	<ol style="list-style-type: none"> 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. 4. In the absence of national law regulating zakat, zakat institution should comply with the internationally accepted reporting standard
Additional criteria	<ol style="list-style-type: none"> 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.

Zakat Governance

57. Zakat governance is the backbone of zakat regulations as it is detrimental to ensure zakat activities operate in accordance to Islamic virtues and domestic legal acts and zakat regulatory framework. By doing so, zakat institutions can become trustworthy institutions to collect zakat funds so optimal level of zakat collection can be reached. Therefore, ZCP 7 – ZCP regulate good governance, which is also important concern to be brought up, not only corporate institutions.

ZCP – 7: Corrective and Sanctioning Power of Zakat Supervisor

58. ZCP 7 specifically regulates corrective sanctioning power of zakat supervisor which has 3 essential criteria and 2 additional criteria, as outlined in **Exhibit 3 (g)** below.

Exhibit 3 (g)

Zakat Core Principle 7

Zakat Core Principles	Key Words
ZCP – 7 <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 and to recommend its revocation.
Essential criteria	<ol style="list-style-type: none"> 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. 2. The zakat supervisor has a broad range of measurement to take timely corrective actions or to impose sanction expeditiously. 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. 4. In the absence of national law regulating zakat, a set of appropriate supervisory procedure including corrective actions and sanctions should be clearly mentioned in the constitution of zakat organization

Additional criteria	<ol style="list-style-type: none"> 1. Zakat act guards against the zakat supervisor unduly delaying appropriate corrective actions. 2. The zakat supervisor may use rating assessment to enhance the corrective actions from zakat institutions.
---------------------	--

ZCP – 8: Good Amil Governance

59. ZCP 8 is the backbone of zakat governance that is important for zakat supervisory authorities to set the governance framework for zakat institutions. Besides, Good Amil Governance is important aspect for zakat supervisory authorities to ensure the good conducts of zakat management through code of conduct, proper fit and proper test, and composition of zakat board. Hence, in order for zakat institutions to have Good Amil Governance, as outlined in **Exhibit 3 (h)** below, zakat supervisors and zakat institutions have to observe 5 essential criteria and 1 additional criteria.

Exhibit 3 (h) Zakat Core Principle 8

Zakat Core Principles	Key Words
ZCP – 8 <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"> 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 support the operations of zakat organisation, it can be paid from other sources with the approval of Islamic council . 2. The zakat supervisor provides guidance to zakat institutions on expectations for sound amil governance. 3. The zakat supervisor regularly assesses a zakat institution's amil governance policies and practices commensurate with shari'ah regulations and systemic importance. 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. 5. The zakat supervisor determines that the zakat institution's Board: <ol style="list-style-type: none"> a) approves and actively oversees implementation of the zakat supervisory direction and strategy; b) establishes and communicates Islamic culture and values through code of conduct; 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); d) establishes conflicts of interest policies and a strong control environment; and e) ensures the effectiveness of amil governance over the zakat institutions' entire management. 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. 7. In the absence of national law regulating zakat, principles of amil governance and its assessment, and the responsibilities of zakat institutions' Boards including succession process should be explicitly and clearly mentioned in the constitution of zakat organization
Additional criteria	<ol style="list-style-type: none"> 1. The zakat supervisor maintains plan for succession to improve the quality of amil officers through certification

Intermediary Functions

60. Zakat institutions have the intermediary functions by collecting zakat funds from muzakki and disburse the zakat funds into the eligible ashnaf and productive activities. In order to have robust intermediary functions, ZCP 9 – 10 are important to be adhered by zakat supervisory authorities and zakat institutions.

ZCP – 9: Collection Management

61. Collection management is a key success factor for zakat institutions performance in collecting zakat funds at an optimal level which has great implications on the outreach for zakat institutions to disburse the zakat funds. Therefore, by adhering ZCP 9 that has 6 essential criteria and 1 additional criteria as outlined in **Exhibit 3 (i)**, zakat institutions are expected to improve the performance on zakat collection.

Exhibit 3 (i)

Zakat Core Principle 9

Zakat Core Principles	Key Words
ZCP – 9 <i>Collection management</i>	The zakat supervisor determines that zakat institutions have adequate policies and processes for nisab assesment and zakatable assets.
Essential criteria	<ol style="list-style-type: none"> 1. Zakat act should designate the institutions that will charge and collect zakat 2. The zakat supervisor determines the exemption limit of zakat (nisab) depend on the source of income or the extent of property accumulation in the light of the shari’ah. 3. The zakat supervisor determines that zakat institutions have appropriate policies and processes for regularly evaluating the various types of zakatable assets. 4. The zakat supervisor determines that zakat institutions’ Board obtains timely and appropriate information on the classification of zakatable assets. 5. 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. 6. The zakat supervisor determines the period of zakat collecting immediately (except in time of disaster). 7. In the absence of national law regulating zakat, nisab assesment and formulation of sources of zakatable items should be conducted by legal Islamic organization or authorized fatawa council.
Additional criteria	<ol style="list-style-type: none"> 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.

ZCP – 10: Disbursement Management

62. To measure the level of outreach and how far the zakat institutions can disburse zakat funds effectively, zakat institutions have to set the operations strategy of effective disbursement management. ZCP 10 that has 15 essential criteria and 3 additional criteria as outlined in **Exhibit 3 (j)** set the parameter for zakat institutions to formulate the strategy in managing zakat disbursement.

Exhibit 3 (j)
Zakat Core Principle 10

Zakat Core Principles	Key Words
<p>ZCP - 10 <i>Disbursement management</i></p>	<p>The zakat supervisor determines that zakat institutions have adequate policies and processes to manage zakat funds and distribution system.</p>
<p>Essential criteria</p>	<ol style="list-style-type: none"> 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. 2. Shari’ah rules, regulations, and the zakat supervisor require zakat institutions to formulate policies and processes to spend zakat for the benefit of beneficiaries (asnaf) as mentioned in Surah At-Taubah verse 60: <ul style="list-style-type: none"> - the poor (<i>fuqara</i>); - the needy (<i>miskin</i>); - those who are deputed to collect zakat; - those whose hearts are to be reconciled; - freeing the slave; - the indebted; - those on the way of Allah; and - wayfarer. 3. The zakat institutions should have proper financial planning, recording and management to prevent mismatch allocation of fund distribution 4. Criteria of the zakat recipients should be clearly determined by the zakat supervisor and must be publicly informed 5. Zakat fund should be distributed for both consumptive-based and productive-based programs. Consumptive-based programs aim to fulfill short term basic needs of mustahik while productive-based programs aim to empower the mustahik to have long term socio economic resilience. 6. Determination on the proportion of consumptive-based and productive-based programs should be based on socio-economic and environmental analysis. This proportion may change overtime depending upon society condition. 7. The zakat supervisor determines that zakat fund from the latest collection period must be distributed maximum for 1 year. 8. The allocation of zakat funds for both consumptive based and productive based program should be conducted in appropriate manner based on shari’ah principles and prevailing law. 9. The zakat supervisor assesses the level of disbursement management by using allocation-to-collection ratio (ACR). 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"> ≥ 90 % : highly effective 70 – 89 % : effective 50 – 69 % : fairly effective 20 – 49 % : below expectation < 20 % : ineffective 10. Zakat funds can be allocated for expenditures at international level. 11. The zakat supervisor should have social benefit indicators that must be achieved as part of the objectives of zakat disbursement programs. 12. 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. 13. 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. 14. The zakat supervisor determines that zakat institutions have policies and processes to prevent persons benefiting from the disbursement arrangements. 15. Shari’ah rules, regulations, and the zakat supervisor set prudent and appropriate

	<p>requirements to control and constrain large disbursement to a single counterparty or a group of connected counterparties. The supervisor also determines that zakat institutions monitor related party disbursement on an ongoing basis.</p> <p>16. In the absence of national law regulating zakat, procedure and mechanism of assessment of zakat distribution should be regulated in the constitution of zakat organization</p>
Additional criteria	<ol style="list-style-type: none"> 1. The zakat supervisor obtains and reviews disbursement information on national level to related parties. 2. The zakat supervisor conducts assessment on the need priority which determines the proportion of consumptive-based and productive-based programs. The zakat supervisor may appoint other institution to conduct the assessment. 3. The zakat supervisor should set up timeline to alleviate poverty and transform mustahik to become muzakki

Risk Management

63. In similar vein to financial institutions, zakat institutions are also exposed towards various risks. Nevertheless, the type of risk exposures faced by zakat institutions is different from financial institutions due to the distinct operations between those two institutions. As risks are still arising in zakat institutions, risks identification, measurement, and mitigation are needed to have sound zakat institutions operating in Muslim countries. Hence, ZCP 11 – ZCP 14 elaborates the guidance for zakat supervisory authorities and zakat institutions with regard four types of risk exposures.

ZCP – 11: Country and Transfer Risk

64. As cross country transactions become imminent in line with globalisation, country and transfer risk is unhindered for zakat institutions as they may transfer the zakat funds into another country for charitable purposes. Generally, the wealthier countries transfer the zakat funds in good faith to the less wealthy country as zakat funds are still remaining in the wealthier countries after completion of zakat disbursement to ashnaf. Due to that reason, zakat institutions are exposed to country and transfer risk. Hence ZCP – 11 recommends 6 essential criteria and 1 additional criteria as outlined in **Exhibit 3 (k)** for managing country and transfer risk.

Exhibit 3 (k)

Zakat Core Principle 11

Zakat Core Principles	Key Words
ZCP - 11 <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"> 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. 2. The donor supervisor assesses a scale priority of recipient country through poverty level, calamity impact and the closest territorial from its donor country. 3. The donor supervisor limits the range of activities by identifying a clear definition and assessment of the eight <i>ashnaf</i>. 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. The confidential information is determined by both supervisors according to prevailing law in their respective country.

	<ol style="list-style-type: none"> 5. The zakat supervisor assesses country and transfer risk model and analysis to reduce potential conflict between donor and recipient country 6. The donor supervisor and the recipient supervisor should agree on division of the managerial fee of amil based on criteria that are set up by both supervisors. The total proportion of amil's managerial fee should not exceed 12.5% from the total zakat transferred. 7. In the absence of zakat supervisor, such as in the case of Muslim minority country, the zakat supervisor may cooperate with foreign zakat organizations that already comply with internationally accepted zakat management standard.
Additional criteria	<ol style="list-style-type: none"> 1. The zakat supervisor, directly or indirectly, cooperates with the relevant foreign zakat supervisors to obtain additional information as needed (eg crisis situations).

ZCP – 12: Reputation Risk and Lack of Confidence

65. Reputation and lack of confidence risk may arise if zakat institutions fail to perform towards the expectations of stakeholders, manage zakat fund collected from muzakki, and in compliance with domestic legal acts and zakat regulatory framework. This particular risk may cause zakat funds collections far below the optimal level if the risk is not well mitigated. In order to manage reputation and muzakki loss risk, ZCP – 12 outlines 3 essential criteria and 2 additional criteria as depicted in **Exhibit 3 (I)** below.

Exhibit 3 (I) Zakat Core Principle 12

Zakat Core Principles	Key Words
ZCP - 12 <i>Reputation Risk and Lack of Confidence</i>	The zakat supervisor determines that zakat institutions have an adequate management framework to handle contagion, reputation, and lack of confidence risks.
Essential criteria	<ol style="list-style-type: none"> 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. 2. The zakat supervisor imposes prudential standards to identify, assess, evaluate, monitor, report, control, and mitigate reputation risk. 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. 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. 5. The zakat supervisor requires that zakat institutions have adequate socialization and education programs to enhance the well-informed public about zakat. 6. In the absence of national law regulating zakat, periodic report to the muzakki should be clearly defined in the constitution of zakat organization.
Additional criteria	<ol style="list-style-type: none"> 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. 2. The zakat supervisor determines that zakat institutions have established appropriate information technology policies and processes to ease a periodic report to the muzakki.

ZCP – 13: Allocation Risk

66. Disbursement risk arising in zakat institutions is akin to liquidity risk in financial position. This risk is present due to misallocation of zakat funds collections to disburse them to 8 ashnaf which leads to shortage of zakat funds to meet all financial obligations. For managing disbursement risk, ZCP – 13 recommends 4 essential criteria and 2 additional criteria to be observed as presented in **Exhibit 3 (m)** below.

Exhibit 3 (m)
Zakat Core Principle 13

Zakat Core Principles	Key Words
ZCP – 13 <i>Allocation risk</i>	Zakat institutions should be able to mitigate allocation risks such as financial position sound and misallocation of distribution activities.
Essential criteria	<ol style="list-style-type: none"> 1. The zakat supervisor requires zakat institutions have established disbursement strategies, policies and processes to identify, assess, monitor and manage disbursement risks. 2. To mitigate misallocation of disbursement, the zakat supervisor determines that zakat institutions have a comprehensive assessment for each <i>ashnaf</i>. 3. 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. 4. 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. 5. In the absence of national law regulating zakat, mitigation procedure on the management of disbursement risk should be mentioned in the constitution of zakat organization and or in other internal regulation.
Additional criteria	<ol style="list-style-type: none"> 1. In order to minimize misallocation problems, zakat institutions may have the measurement of <i>had al-kifayah</i> as minimum adequacy for the needs of individual rights. 2. Zakat institutions may further enhance a sound disbursement risk management through collaboration with other financial sectors such as Islamic banking and awqaf sector.

ZCP – 14: Operational and Shariah Compliant Risk

67. Human error, inadequate IT system, improper strategy and governance structure, and any other operational disturbances may cause operational and shariah compliant risk. This risk has to be well anticipated with appropriate policies and procedures set by top level management of zakat institutions. Thus, ZCP – 14 that has 4 essential criteria and 1 additional criteria aims at recommending strategy to manage operational and shariah compliant risk in zakat institutions.

Exhibit 3 (n)
Zakat Core Principle 14

Zakat Core Principles	Key Words
ZCP – 14 <i>Operational and shariah compliant risk</i>	The zakat supervisor determines that zakat institutions should have proper operational and shariah compliant risks management to minimize potential fraudulent practices, anticipation towards system breakdown and any other potential disturbance.
Essential criteria	<ol style="list-style-type: none"> 1. The management unit should have proper methodology to identify, measure, mitigate and monitor the operational risk and shariah compliant risk. 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>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 and shariah compliant risk.</p> <p>5. In the absence of national law regulating zakat, the presence of shariah supervisory council or fatawa council is highly needed in order to ensure shariah compliant aspect. Appointment procedure and operational mechanism of this council should be regulated in the constitution of zakat organization.</p>
Additional criteria	1. Zakat supervisor may require zakat institutions to have shariah supervisory council to ensure that shariah compliant aspect is in place

Shari’ah Governance

68. Shari’ah governance that covers audit, disclosure, and transparency aspects is important dimension to ensure shari’ah compliant in every aspect of operational zakat activities. ZCP 15 – ZCP 18 provide comprehensive guidance to the top level management of the zakat institution in discharging its duties in matters relating to shari’ah.

ZCP – 15: Shari’ah Control and Internal Audit

69. In order to monitor and ensure zakat operational activities are shari’ah compliant, shari’ah control and internal audit is vital aspect to be observed by zakat supervisory authorities to conduct supervision. Zakat institutions must also uphold adequate shari’ah control and internal audit to minimise operational and shari’ah governance risk. Hence, ZCP 15 outlines 3 essential criteria as presented in **Exhibit 3 (o)**.

Exhibit 3 (o)

Zakat Core Principle 15

Zakat Core Principles	Key Words
ZCP – 15 <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"> a) organizational structure; b) zakat accounting policies and processes; and c) segregation of zakat funds and other charitable funds. <p>2. The zakat supervisor determines that the internal audit function:</p> <ul style="list-style-type: none"> a) has sufficient and qualified resources that are suitably trained, have relevant experiences and have sufficient authority to perform their role; 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>3. The zakat supervisor determines that zakat institutions have an adequately staffed, permanent, independent, shari’ah control and internal audit function charged with:</p> <ul style="list-style-type: none"> a) assessing whether existing policies, processes, shari’ah control and internal control are effective, appropriate and remain sufficient for zakat institution’s performances; and b) ensuring that policies and processes are complied with. <p>4. In the absence of national law regulating zakat, shariah control and audit should be properly conducted by appointed shariah supervisory council and or fatawa council.</p>
Additional criteria	–

ZCP – 16: Financial Reporting and External Audit

70. Accountability is important element within shari’ah governance for ensuring a fair judgment from external parties. To uphold accountability, financial reporting and external audit must be conducted. ZCP – 16 outlines 3 essential criteria and 1 additional criteria as presented in **Exhibit 3 (p)** below.

Exhibit 3 (p)

Zakat Core Principle 16

Zakat Core Principles	Key Words
ZCP – 16 <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"> 1. The zakat supervisor holds the zakat institution’s Board and management responsible for: <ol style="list-style-type: none"> a) ensuring that financial statement are prepared in accordance with accounting practices that are widely accepted nationally; and b) ensuring that the financial statement issued annually to the public bear an independence external auditor’s opinion. 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. 3. The zakat supervisor has the power to reject and rescind an unprofessional external audit. 4. In the absence of national law regulating zakat, external audit and annual publication should comply with relevant regulation and internally should be regulated in the constitution of zakat organization.
Additional criteria	<ol style="list-style-type: none"> 1. The zakat supervisor has the power to access external auditors’ working paper.

ZCP – 17: Disclosure and Transparency

71. Apart from accountability, disclosure and transparency must also be upheld by zakat institutions to retain fair judgment from the public with regard to zakat operational aspects. In that respect, ZCP - 17 has 3 essential criteria outlined in **Exhibit 3 (q)** below.

Exhibit 3 (q)

Zakat Core Principle 17

Zakat Core Principles	Key Words
ZCP – 17 <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"> 1. Laws, regulations or the zakat supervisor require zakat institutions to publish periodic disclosures of information on a consolidated. 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. 3. The zakat supervisor or another relevant agency effectively reviews and enforces compliance with disclosure standards. 4. In the absence of national law regulating zakat, publication of regular consolidated information should be regulated in the constitution of zakat organization as part of organizational transparency and accountability.
Additional criteria	–

ZCP – 18: Abuse of Zakat Services

72. Abuse of zakat services makes zakat institutions incompliant with shari’ah. Activities such as financing terrorism, money laundering, corruption and any acts contradict with shari’ah values must not be tolerated. Hence, ZCP – 18 that has 6 essential criteria and 1 additional criteria is a shield for zakat institutions from any non-shari’ah compliant acts.

Exhibit 3 (r)

Zakat Core Principle 18

Zakat Core Principles	Key Words
ZCP – 18 <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"> 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. 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. 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. 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. 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. 6. The zakat supervisor has power to take appropriate action against a zakat institution that does not comply with its obligation regarding criminal activities. 7. In the absence of national law regulating zakat, prevention of criminal activities and procedure of corrective actions should be regulated in the constitution of zakat organization. Local government may intervene according to local regulation.
Additional criteria	<ol style="list-style-type: none"> 1. The zakat supervisor, directly or indirectly, cooperates with the relevant domestic and foreign supervisory authorities.

Bibliography

- Ahmed, H. (2004). *Role of Zakat and Awqaf in Poverty Alleviation*. Jeddah: IRTI-IDB.
- Al-Qardawi, Y. (1993). *Fiqhuz Zakat*. Jakarta: Litera Antar Nusa.
- Al-Qardawi, Y. (2002). *Zakat Role in Curing Social and Economic Malaises*. In Kahf, M (Ed). *Economics of Zakat*. Jeddah: IRTI – IDB.
- Basel Committee on Banking Supervision. (2012). *Core Principles for Effective Banking Supervision*. Bank for International Settlements.
- Beik, I. S. (2013). *Economic Role of Zakat in Reducing Poverty and Income Inequality: A Case Study in the Province of DKI Jakarta, Indonesia*. Germany: LAP Publishing.
- Chapra, M. U.(2006). *The Islamic Welfare State and Its Role in the Economy*, in Sadeq, A. M. (ed), *Development Issues in Islam*. Kuala Lumpur: International Islamic University.
- Firdaus, M., Beik, I. S., Irawan, T., Juanda, B. (2012). “Economic Estimation and Determinations of Zakat Potential in Indonesia”. IRTI Working Paper Series WP#1433-07.
- Hassan, M. K., and Ahmed, M. (2000). “Poverty Alleviation and Zakat Funds: Substitutability of Zakat Funds in the Budget of the Government of Bangladesh”. The Balance, Spring.
- Ibn Hazm. (1959). *Al-Muhalli Sharh ‘ala Minhaj al Talibin*. Cairo: Mustafa al-Babi al-Halibi.
- IRTI (Islamic Research and Training Institute) (1985). *Management of ZakaH in Modern Muslim Society*”. Paper presented at the first Seminar on Management of Zakah in Modern Muslim Society, held in Karachi, Pakistan, 22 April – 02 May, 1985.
- Kahf, M. (1993). *Zakah Management in Some Muslim Societies*. Background Paper No. 11. Jeddah: IRTI-IDB.
- Kahf, M. (2002). *Economics of Zakat*. Jeddah: IRTI-IDB.
- Mannan, M. A. (2000). *Effects of Zakah Assessment and Collection on the Redistribution of Income in Contemporary Muslim Countries*, in Imtiaziet al (ed), *Management of Zakah in Modern Muslim Society*. Jeddah: IRTI-IDB.
- Mintarti, N., Beik, I. S., Tanjung, H., Haryono, A. R., Tsani, T., Kasirin, U. (2012). *Indonesia Zakat and Development Report 2012*. Ciputat: IMZ.
- Pramanik, A. H. (1993). *Development and Distribution in Islam*. Petaling Jaya: Pelanduk Publications.
- Sadeq, A. M. (2002). *A Survey of the Institution of Zakat: Issues, Theories, and Administration*. Jeddah: IRTI-IDB.

Shirazi, N.S. (1996). "Targeting, Coverage, and Contribution of Zakat to Household's Income". *Journal of Economic Cooperation among Islamic Countries*, vol. 17:3-4.

World Bank. (2008). *World Development Indicators 2008*. Washington D.C.: The International Bank for Reconstruction and Development/The World Bank.