Internal Audit in Zakat Institutions: Structure and Operational Activities

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ABSTRACT

The urge of applying good governance in organisation has promoting the importance of internal audit function. The internal audit is considered as an important tools for management to achieve its objectives and improve company performance. Meanwhile, zakat institutions are seen as important unit in development of Malaysian economics. The stake holders as well as the society interested to know how this zakat money being efficiently managed and finally reach the asnaf groups. Since internal audit function is one of key tool of efficient management, so it plays an important roles in ensuring the zakat money is managed efficiently. Thus, it has made the increase importance of the internal audit functions in zakat institutions. Hence, this paper is try to explore the structure and operational activities of internal audit department in zakat institutions. Data was collected through in-depth interviews conducted with the chief audit executive and internal auditors of selected zakat institutions. This study found that two out of four selected zakat institutions have put the responsibility of internal audit on specific department. Meanwhile another two have implemented the function of internal audit through audit quality department or audit quality committee. Focus of audit work is given more on accountability of zakat collections and distributions.

Keywords: Internal audit, internal audit effectiveness, zakat governance.

INTRODUCTION

The urge of applying good governance in organisation has promoting the importance of internal audit function. It has increased the understanding of internal audit (IA) function as a potential tool to be utilised for company to achieve its goals and better performance. The IA function exists to help members of an organization to improve the performance of their activities (Ali et al, 2012).

In common business structure, IA department normally would be put under the audit committee (AC). To ensure the independence of the internal auditors, they would be given direct access of communication with the AC members. Meanwhile, for public listed company, IA functions is also one of the listing requirement of Security Commission (SC).
Its functioned has clearly defined in the guidelines of IA function as released by SC in July 2002. This guidelines assist on how the boards of directors of public-listed companies in the effective discharge of their responsibilities in relation to the establishment of internal audit functions. Thus it shows the important of IA function in contributing towards higher standards of governance.

Basically IA is needed in reviewing the existence of control and its relevancy with current operation. There are also organization put the trust on IA department to assess potential problems and issues for every business plan they would like to invest.

The roles of IA seem to be widened. Business organizations start to enhance the function of its IA, not only in monitoring and control but also as risk assessor and business advisor. Nowadays, internal auditor also plays an important role in assisting the audit committee in fulfilling their jobs. Internal auditor is expected to have good skill in assessing risk (Ahmad, et.al. 2009; Dittenhofer, 2001) and develop an action plan how to mitigate those risks. IA ability in understanding and appreciating business processes of a company enable it to provide valuable advises to management for improvement and reducing risk.

**Zakat Institution (ZI) in Malaysia**

In Malaysia, zakat management is under the State Islamic Religious Council (SIRC). Thus every state would be governed by different zakat state’s enactment or zakat law. Yusuf Qardawi (1988) depict the importance of zakat management under the government since it is a society issue not the personal issue. Thus, the government should ensure the efficiency and accountability of collection and distribution process.

Zakat institutions plays significant responsibility in economic development because they are liable to collect and distribute zakat effectively and their failure will affect the entire zakat management (Basir, Azmi, Ismail, Ibrahim & Mohamed, 2017). Zakat that was paid to ZIs will be distributed to eight *asnaif/beneficiaries* which are clearly specified in the Qur’an (surah At-Taubah; verse 60). The *asnaif* include the poor, the needy, the administrator of zakat, those whose heart are to be inclined (including new Muslim converts who lack economic support), the slaves, debtors (debts due to real needs), in the cause of Allah (*Fi sabillillah*), and the wayfarers.

Being an institution that manages public funds, people are looking at the performance and accountability of ZI in managing zakat funds. With the growing size of zakat collection every year, there is increased attention given to the ZIs. The stake holders as well as the society interested to know how this zakat money being efficiently managed and finally reach the *asnaif* groups. Additionally, as a religious institution, people are looking at the good governance of the ZIs. However, prior studies have shown that zakat payers were still questioned about the issue of accountability among zakat institutions in Malaysia and suggested continuous improvement towards the current disclosure practices (Sapingi, Nelson, & Obid, 2016).

The continuous improvement can be applied if the institution actively makes use of their internal audit function. Nowadays, the evolution of auditing practices emerge to detect fraud and improve financial accountability (Baharuddin, Shokiyah, & Ibrahim, 2014). Therefore this research would try to explore the position of internal audit function in four selected zakat institutions in Malaysia. The aim is to investigate whether the internal audit is
given appropriate function and supports such as proper structure and staffs as well as to review how the operational activities of this department.

LITERATURE REVIEW

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Al-Matari, Al-Swidi and Fadzil (2014) stated that internal audit is a backbone of the business accounting where they need to ensure that the application of accounting systems is in place and assessing the operation of department. Internal audit function defined by the International Standard of Auditing (ISA 610, 2013, p.2, 14(a)) as: “A function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity’s governance, risk management and internal control processes” (International Federation of Accountants, 2013).

The roles of internal auditors comprise of communication, management intimidation, technical, risk management support, control oversight, decision support, system involvement and governance (Mahzan, Zulkifli, & Umor, 2012). Internal audit must have an independent attributes from any management control where they cannot influence any further information, conclusions and assessments of internal audit. As stated by Al-Matari, Al-Swidi, and Fadzil (2014), independent is an important element in determining the success of the implementation tasks by internal audit where they determines the reliability, reality, and integrity of financial and operational information.

Internal audit effectiveness is strongly influenced by internal audit quality and management support, whereas organizational setting and auditee attributes do not have a strong impact on audit effectiveness (Minhet & Yismaw, 2007). In addition, internal audit is effective when the function meets the expectation of the management, audit committee, external auditor and auditees (Lenz & Hahn, 2015). Besides that, internal audit is effective when it is risk based and effective internal audit require skills and competences (Lenz & Hahn, 2015) and also the internal audit are independent, objective and have enough management support (Baharud-din et al., 2014).

Additionally, good organizational status enables audit works to run smoothly and get useful audit findings that lead to proper report (Mahzan & Hassan, 2015). However, prior study in Saudi public sector shows that internal audit function has no real organizational status and they have difficulty to achieve independence objective (Alzeban & Sawan, 2013). A study in Malaysia also found that internal audit function in public sector also have the difficulties in auditing their own “boss” due to lack of independence (Shamsuddin et al., 2014).

RESEARCH METHODOLOGY

This paper uses qualitative method which is semi-structured interview to get data from the auditors and develop understanding on the structure and operational activities of the IA department that may lead to effectiveness of internal audit function. The interview method
was used by prior studies on internal audit function (Alzeban & Sawan, 2013) and disclosure practices by zakat institutions (Sapingi et al., 2016). This paper explores the effectiveness of internal audit function from auditors perspective in four selected zakat institutions in Malaysia, namely ZI 1, ZI 2, ZI 3 and ZI 4. The interview questions were developed based on the ISA610 (2013) and findings from prior research. The interview questions were sent by e-mail service as a notification to our respondent about our coverage of discussion after they make a confirmation to give their cooperation. The interview session was conducted around thirty minutes to one hour with the representative auditors.

RESULT

IA Structure in ZIs
This paper try to explore the structure and operational activities of the IA department that may lead to effectiveness of IA function. The findings show the IA has a proper structure in each ZIs and its function perceived to be important and significant in achieving efficiency of operational activities. This section discusses in details the findings and analysis.

Based on Table 1, it shows that ZI1 and ZI2 has a specific IA department. Meanwhile for ZI3 the function of IA is merged with audit quality function, thus it put under the same department. Whereas for ZI1 and ZI2, they have separate department for audit quality. ZI4 do not have specific IA department even they put it in organizational charts. The function of IA is given to audit quality committee. This committee was established by the initiative of the top management of ZI 4 with awareness that every transactions and activities need to be monitored by independent party. This committee consist of experienced staffs from all departments.

ZI2 is the only ZI which has direct access of communication with audit committee (AC). This team also has frequent meeting with the chairman whom also the AC member and normally received orders directly from the chairman. Meanwhile for ZI1, ZI3 and ZI4, they also have access with AC and Board of Directors (BOD), but any findings from the audit need to be discussed first with the top management of ZI. Then the result would be bring to BOD/AC meeting.

Table 1: Internal Audit Structures and Operational Activities

<table>
<thead>
<tr>
<th>Characteristic</th>
<th>ZI 1</th>
<th>ZI 2</th>
<th>ZI 3</th>
<th>ZI 4</th>
</tr>
</thead>
<tbody>
<tr>
<td>IA Structures</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Specific IA Department</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes, Audit Quality Department</td>
<td>No, Audit Quality Committee</td>
</tr>
<tr>
<td>2 Reporting to</td>
<td>Top management</td>
<td>Audit Committee (AC)</td>
<td>Top management</td>
<td>Top management</td>
</tr>
<tr>
<td>3 Independence</td>
<td>Direct access with AC with management consent.</td>
<td>Direct access with AC.</td>
<td>Direct access with AC with management consent.</td>
<td>Direct access with AC with management consent.</td>
</tr>
<tr>
<td>4 Qualification and background of Chief Internal Auditor</td>
<td>Certified accountant, &lt;40yrs old, experience in govt. agency</td>
<td>Certified Accountant, &gt;40yrs old, well experienced in corp.sector</td>
<td>Non-accounting, &gt;40yrs old, well experienced in zakat operation</td>
<td>Non-accounting, &gt;40 yrs old, well experienced in zakat operation</td>
</tr>
<tr>
<td>5 No of Internal Auditors</td>
<td>3 (mix background)</td>
<td>9 (mix background)</td>
<td>2 permanent auditor</td>
<td>12 to 15 quality auditor from all</td>
</tr>
</tbody>
</table>
IA department in ZI1 and ZI2 are led by CAE with certified accountant qualification but with huge gap of experience. Apparently CAE of ZI2 has more than 10 years experiences in corporate and finance sector. Meanwhile IA in ZI3 and ZI4 are led by well experience operational executives but do not have any background in accounting field. Since the focus of IA are in operational and control activities, the operational experience of CAE is an advantage to ensure the IA would be benefited the ZIs. They are able to understand potential risk that might happen in future due to implementation of new procedures or plans. They also able to resolved immediately any issues regarding operational activities and provide reasonable and doable improvement action.

ZI2 has the highest number of staffs which are 9. In fact ZI2 also being supported by two other department which are audit quality department and risk management department. They are coordinating their works. Meanwhile, ZI1 and ZI3 is still looking forward for new staffs because the current number of staffs available are not enough to support the organisation. ZI4 do not have any specific internal auditors, thus they are planning to hire new CAE that may able to lead the IA department. For ZI3 and ZI4, since they are supported by significant amount of quality auditors which come from other departments, there are limitations in term of number of audit plan being executed. Each quality auditor is also bounded with their own department responsibilities.

Besides that, all other three selected ZIs (ZI1, ZI2, ZI3) hired mix background of internal auditors. They are not necessarily having accounting and auditing background. Some of the fields mentioned are engineering, information technology (IT), Islamic study, actuarial science and even sports science. The mix balance between varieties of educational background plus the past working experienced are seen as synergy to the IA department of ZIs.

**Operational Activities of IA in ZIs**

Based on the interviews conducted, we find out that IA plays an important roles inside the ZIs. Internal auditors is not only view as controller but also advisor to the management and directors.

In general, IA in ZIs responsible to ensure the efficiency of controls systems, compliance to policies and procedures and risk assessment. IA also responsible for continuous review on policies and procedures in order to improve control systems, operational activities and compliance. IA is also expected from time to time to provide reasonable advise and doable improvement actions.
For ZI1, most of the audit works are based on risk-based audit, whereby the team would analyse the potential risk that may occur and then conduct the audit procedures focusing on the high risk area. Meanwhile for ZI2, as mentioned earlier, ZI2 has established its own risk management department which work side by side with IA department. ZI3 has implement risk assessment procedures in IT department only and ZI4 still do not implement any risk assessment procedures.

Most of ZIs selected less focus on financial audit except for ZI2 which they also review on compliance on financial standards in preparation of financial statements. This might be due to less expertise and qualification among internal auditors in conducting financial audit. Furthermore as mentioned earlier they are more focus on the zakat collection and distribution.

As stated in Table 1 above, all ZIs conduct the same types of audits which are compliance audit, operational audit, investigation audit and information technology (IT) audit. IT audit is one of the attention given due to the high dependant on IT applications among ZIs. Nowadays zakat money can be done through multiples applications such as online, smartphones, debit and credit card and internet banking.

In future ZI2 is also looking forward for implementing syariah audit, thus experts in syariah field would also be needed.

CONCLUSION

In conclusion we conclude that the IA department plays very important roles in ZIs. IA department is having proper reporting structure with reasonable level of independence. It also has blended background of experience staffs and lead by well experience CAE. However there are rooms for improvement. For example increase number of staff especially staff with financial audit experience. Besides that for ZI with no specific audit department, might be able to establish the IA department with suitable staff and CAE.

Since the PZs have very unique function in society, as a non-profit organization, thus the IAD works focus more on the accountability and quality of collecting and distributing process of the zakah money. The yearly audit plan is developed based on operational activities of this functions. By doing this, they believe they would be able protect public confidence towards zakah institutions as a whole. It is also can be concluded that the IAD in PZ less focus on audit of financial reporting.

REFERENCES


