Commentaries

Shariah Non-compliance Risk (SNCR) Management Framework Adoption Beyond Islamic Banking: Exploring Its Adoption in Philanthropy Operations

Muhammad Abdul Mubeen[1]–Group Head of Shariah Department, Standard Chartered Bank & Shariah Committee/Board Member Standard Chartered Bank Pakistan and Malaysia

Professor Dr. Zurina Shafii[2]–Faculty of Economics and Muamalat (FEM), & Islamic Finance and Wealth Management Institute (IFWMI), Universiti Sains Islam Malaysia

Abstract

Shariah non-compliance (SNC) risk management is essential for Islamic institutions to align their operations with Shariah law, thereby preserving public trust, ethical integrity, and operational legitimacy. While SNC risk management has traditionally been applied within the Islamic banking sector, this paper investigates its applicability and potential benefits within Islamic philanthropic operations, specifically waqf and zakat. These institutions, rooted in religious and ethical mandates, require robust governance frameworks to ensure transparent fund management, standardized reporting, and sustained donor confidence. Drawing on lessons from the Islamic finance sector, this study advocates for the implementation of standardized SNC risk management frameworks that incorporate Shariah audit practices and structured compliance mechanisms. These frameworks are essential to enhance oversight, promote ethical governance, and address challenges such as decentralization, inconsistent practices, and limited Shariah expertise. Through qualitative interviews with two high-performing state Islamic religious councils (SIRCs) in Malaysia, this study explores the specific SNC-related risks faced by philanthropic organizations and evaluates the importance of Shariah-compliant risk management in strengthening institutional governance. Ultimately, this research aims to

support the broader institutionalization of SNC frameworks in Islamic charitable sectors, ensuring long-term integrity, accountability, and alignment with Maqasid al-Shariah. This study contributes to the knowledge by expanding the scope of Shariah Non-Compliance risk management from Islamic finance to Islamic philanthropy (waqf and zakat). It fills a governance gap by proposing standardized SNC frameworks for these institutions, supported by case insights from Malaysian state Islamic religious councils. The research also links SNC practices to Maqasid al-Shariah, highlighting their role in promoting ethical integrity, transparency, and public trust in the Islamic social finance sector.

***Keywords**:* SNC, risk management, Islamic philanthropy, legal framework, governance, compliance

Introduction

In Islam, the importance of philanthropy is mentioned in the Quran and Sunnah. This act is considered as Ibadat (prays) for the Muslim and is a central aspect of Islamic teachings. This aspect of Islam touches on the social responsibility of Muslim Ummah, which is based on the principles of compassion and justice. It brings the responsibility of caring for less fortunate individuals in society and fostering a sense of community and equity. Therefore, in Islam it is obligatory for Muslims to pay a specific portion of their wealth (either in the form of zakat or sadaqat ul fitr) to poor and needy people on a yearly basis, while virtues and encouragement are mentioned for Muslims who spend above their specific obligatory responsibility as sadaqah. In addition, Islam provides Muslims who want their charity to extend beyond their death to participate in waqf (Islamic Endowment): "a perpetual sadaqah (charity) typically involving property or assets." This concept of waqf actually gives the opportunity to start and establish big, long-lasting public welfare projects such as building mosques, schools, hospitals, or funding scholarships, etc.

The Quran encourages giving from one's wealth: "Those who spend their wealth in the way of Allah … will have their reward with their Lord" (2:274). Another verse emphasizes compassion: "You will not attain righteousness unless you give from what you love" (3:92). Prophet Muhammad (PBUH) described charity as an act that benefits both the giver and receiver: "Charity does not decrease wealth …" (Sahih Muslim). He also encouraged ongoing acts of charity, "When a man dies, his deeds come to an end except for three: ongoing charity, beneficial knowledge, or a righteous child who prays for him" (Sahih Muslim).

The abovementioned concepts of charities, either zakat, sadaqah or waqf, have specific principles, guidelines, and requirements that must be adhered to. To miss any principle or inappropriate application of any guideline or requirement, will make it not compliant with Shariah. Hence, it will nullify the purpose of the charity, the payment will not be considered acceptable from a Shariah perspective, and the individual may be required to pay it again to fulfill his/her religious responsibility.

As Shariah conformity/compliance is the core of Islamic philanthropy, particularly for zakat and waqf, a failure to comply is known as Shariah non-compliance risk (SNCR). Therefore, SNCR management has become a critical and important function for philanthropic organizations. They are required to develop a strong governance and risk management system, and through dedicated expert staff, keep, maintain, and control and monitor the operations of the organization.

To enhance governance, there should be a standardized SNCR management framework that should be followed by philanthropic organizations. This paper advocates the implementation of standardized frameworks that mandate standardized reporting, improve oversight, and integrate Shariah audit practices. Training for management on compliance and risk assessment can further strengthen governance.

This study also explores key governance challenges in Malaysia focusing on the decentralized nature of zakat and waqf institutions and investigates specific risks faced by these philanthropic organizations. Using qualitative interviews with two high-performing SIRCs in Malaysia, this study delves into the importance of Shariah-compliant risk management for the effective administration of waqf and zakat funds. Section 2 focuses on Shariah non-compliance risk, Section 3 is a case study on governance and risk management in SIRCs, section 4 explains the Methodology used in this research, and section 5 explores the management of SNCR. Finally, section 6 offers a suggested framework for managing SNCR.

Shariah Non-compliance Risk

Risk is defined as "the possibility of an adverse outcome of a future course of action" (Gallagher & Andrew, 1997). Shariah risk refers to the risk that arises due to the failure to comply with Shariah principles. Shariah non-compliance risk is one of the most unique risks in Islamic institutions, including financial institutions, where they are required to apply Shariah guidelines, principles, and rules to all activities and functions. Failure to comply creates the risk of SNC. The Islamic Financial Services Board (IFSB) defines SNCR as "the risk that arises from IFIs' failure to comply with the Shariah rules and principles determined by the Shariah Board/Committee of the IFIs or the relevant authority/body in the jurisdiction in which the IFIs operate" (IFSB, 2005). Shariah non-compliance risk in philanthropy refers to the failure of a philanthropic organization to adhere to Shariah guidelines, principles, and rules.

Major Shariah Non-compliance Risk in Philanthropy

There are four major risks regarding Shariah non-compliance in philanthropy: mismanagement of funds, inappropriate distribution, and operational and governance risks. The mismanagement of funds risk is when zakat, sadaqah and waqf funds are not usedas according to Shariah guidelines. For example, investing the funds in non-Shariah compliance financial institutions (such as conventional banking or fund managers) or using such

funds in a project that is not aligned with Shariah principles (such as alcohol, gambling or unethical industries). This can also include mixing zakat, sadaqah, or waqf funds with each other.

Inappropriate distribution risk means that zakat will not be paid on time and will not be distributed among the eight defined beneficiaries as mentioned in Quran. Due to a lack of expertise and the unavailability of professional talent in Islamic philanthropy, there is a risk that funds could be misused and neither distributed nor invested properly per Shariah guidelines, which could be categorized as operational risk. Organizations should, therefore, screen partners and projects for Shariah compliance. Finally, there are governance risks. Due to the unavailability of expertise and Shariah committees, there is weak control and oversight on the functions of Islamic philanthropy to adhere to Shariah requirements.

Significance of Shariah Non-compliance

Failure to manage the above risks, will lead to (a) reputational damage, (b) regulatory implications, (c) loss of donor trust, and (d) the legitimacy of the payments. Reputational damage may raise questions on the credibility of the Islamic philanthropic organization, whether it is Shariah compliant. Regulatory implications may create legal repercussions in jurisdictions where Islamic philanthropic organizations exist and require adherence to Shariah principles. This may result in the imposition of disciplinary, civil, or criminal sanctions. Loss of donor trust can occur when individuals as no longer comfortable donating to a non-Shariah compliant organization. Finally, the legitimacy of payments of zakat, sadaqah, and waqf may be questioned when there is a failure to comply with Shariah. This raises questions as to whether they are paid per Shariah requirements or will need to be paid again.

Case Study: Governance and Risk Management in SIRCs

In Malaysia, the management of Islamic social finance, including zakat and waqf funds, falls under the jurisdiction of the State Islamic Religious Councils. There are currently 14 SIRCs, each established based on the Federal Constitution (Schedule 9, List 2), granting states the authority to oversee zakat, waqf, and other Islamic social funds (Mahadi et al., 2018). Additionally, Section 25 of the Civil Law Act 1956 mandates that the administration of Muslim property must adhere to Islamic law, making Shariah the governing law for zakat and waqf (Kamaruddin et al., 2018). In terms of waqf governance, the state rulers serve as the heads of Islamic affairs, supported by SIRCs in administering waqf institutions (Norzilan, 2018).

Due to the decentralized nature of SIRCs, each state practices different management approaches for waqf institutions (Aziz & Ali, 2018). This results in inconsistencies in monitoring and reporting practices across zakat and waqf institutions. To address these discrepancies, the Malaysian government established the Department of Waqf, Zakat, and Hajj (JAWHAR) in 2004 to coordinate waqf administration. However, JAWHAR's role remains limited due to the separation of powers between the federal and state governments, with

jurisdiction over waqf belonging to SIRCs rather than JAWHAR (Mohamad Suhaimi et al., 2014). This section explores key governance challenges, focusing on the decentralized nature of zakat and waqf institutions, and investigates specific risks faced by these philanthropic organizations. Using qualitative interviews with two high-performing SIRCs in Malaysia, this study delves into the importance of Shariah-compliant risk management for the effective administration of waqf and zakat funds.

Governance and Risk Management in SIRCs

SIRCs are responsible for overseeing the management of zakat and waqf funds, but Shariah monitoring practices differ across states. Most zakat and waqf institutions refer to the State Fatwa Committee for guidance on Shariah matters. Additionally, several states have established dedicated Shariah departments to manage daily Shariah-related activities and operations. However, it has been observed that no zakat or waqf institution in Malaysia has formally incorporated Shariah audit practices into their operations (Kamaruddin & Hanefah, 2021a).

The decentralization of zakat and waqf governance across different states has contributed to variations in governance structures. This is unlike the practice in Indonesia that governs waqf and zakat affairs at central governance, referring the guidance and resolutions from Majlis Ulama Indonesia (MUI). The decentralized approach adopted for waqf and zakat management is dissimilar to the structure of governance for the Islamic finance industry, as it is centralized at the regulator level, namely Bank Negara Malaysia and the Securities Commission.

In terms of operational governance, some zakat and waqf institutions operate as corporatized entities, while others remain noncorporate, leading to differences in governance practices. For instance, research on zakat financial management has shown that these structural differences result in variations in the application of zakat guidelines, the types of zakat collected, and inconsistencies in reporting and information disclosure (Anuar et al., 2019). Similarly, studies on waqf governance found that corporatized waqf institutions tend to have stronger governance practices compared to their non-corporatized counterparts (Kamaruddin & Hanefah, 2021a). Corporatized institutions are required to submit to internal audit practices and share their financial statements with the Companies Commission of Malaysia. The embedded governance and audit mechanism within the corporatized zakat and waqf institutions results to more robust check and balance practices as compared to non-corporatized institutions. As for the non-corporatized institutions, check and balance mechanisms are provided by the internal audit function monitored by the Board of Directors. At this juncture, an external Shariah audit is not made compulsory for both corporatized and non-corporatized institutions, thus the assurance is achieved through an internal audit exercise. One notable difference between internal and external audits is the reporting responsibility that the institutions owe to the stakeholders. An internal audit report is not

available for external stakeholders, thus limiting the scrutiny of the general public.

The governance of SIRCs in Malaysia revolves around the management of zakat and waqf funds, guided by Islamic law. Each SIRC operates under state jurisdiction, leading to varied practices and governance structures across the 14 states in Malaysia. While SIRCs are responsible for overall monitoring, the decentralized nature creates inconsistencies in reporting and compliance. The presence of both corporatized and non-corporatized institutions further complicates governance, with corporatised entities generally exhibiting better practices. A centralised framework and enhanced Shariah auditing could improve governance across SIRCs.

Risk Management Practices in SIRCs: The Need and the Challenges

Risk management within the State Islamic Religious Councils in Malaysia is essential for the effective administration of Islamic social finance, specifically in managing zakat and waqf funds. Due to the decentralized structure of SIRCs, each council operates independently, which leads to variations in governance and operational frameworks across the country. This decentralization introduces several risks, such as inconsistent reporting standards, discrepancies in fund collection and distribution, and varying levels of compliance with Shariah principles.

A key element of risk management in SIRCs is the implementation of Shariah governance frameworks, designed to ensure that zakat and waqf operations align with Islamic law. While some states have established dedicated Shariah departments to oversee daily operations, the absence of standardized Shariah audit practices across all SIRCs creates a significant gap in compliance monitoring. Without a uniform Shariah audit system, the risk of financial mismanagement or fraud increases, potentially undermining public trust in these institutions.

In addition to Shariah governance, another critical aspect of risk management is the separation of collection and distribution functions within certain zakat institutions. This structural division helps mitigate the risk of fund misallocation by ensuring that zakat is distributed to rightful recipients in accordance with Islamic guidelines. However, the disparities between corporatized and non-corporatized zakat and waqf institutions pose additional risks. Corporatized institutions typically demonstrate stronger risk management practices, while non-corporatized entities may struggle with governance challenges.

Moreover, external factors such as political and social influences also impact risk management within SIRCs. As public entities, these councils must navigate the expectations of various stakeholders, including zakat payers, waqf donors, and government bodies. To mitigate these external risks, SIRCs need to adopt more transparent reporting practices and reinforce their governance frameworks to withstand external pressures. By doing so, they can strengthen accountability and maintain public confidence in their management of Islamic social finance.

Shariah Audit as a Risk Management Tool for Zakat and Waqf Institutions

In the context of risk management for zakat and waqf institutions in Malaysia, implementing Shariah audits is essential to ensure that governance and operational practices align with Islamic principles. Given that zakat and waqf are critical components of Islamic social finance, the proper administration of these funds is paramount, particularly considering the decentralized governance structures across the 14 State Islamic Religious Councils. Each state adopts a unique approach to managing zakat and waqf, resulting in inconsistencies in governance, reporting, and auditing practices. These discrepancies heighten the risks of mismanagement and noncompliance with Shariah principles.

A Shariah audit serves as an inspection and verification process aimed at confirming adherence to Islamic law in financial and operational activities. It is a strategic tool for mitigating risks within zakat and waqf institutions by ensuring compliance with Shariah principles in all aspects of fund management, including the collection, management, and distribution of zakat and waqf. By doing so, the audit helps reduce the risks of fraud, misallocation of funds, and operational inefficiencies. For instance, during the collection phase, the audit verifies that donations originate from halal sources, confirming the legitimacy of the funds. In the distribution phase, the audit ensures that funds are allocated to rightful recipients as stipulated in the Qur'an, thus upholding Shariah principles.

Moreover, Shariah audits are instrumental in overseeing the proper use of operational funds managed by amil (zakat administrators) and mutawalli (waqf trustees). The audits confirm that the rights and responsibilities of these parties are respected and executed in accordance with Islamic law. This comprehensive approach to auditing, which encompasses both financial and operational aspects, establishes a robust framework for managing risks within zakat and waqf institutions.

Zakat and waqf institutions in Malaysia must integrate Shariah audits as a critical element of their risk management strategy. These audits ensure that funds are managed in accordance with Islamic principles, thereby enhancing accountability and public trust. To tackle the current governance challenges, establishing standardized audit guidelines at the national level is crucial, along with ensuring their consistent application across all SIRCs. Additionally, expanding the role of JAWHAR to oversee and enforce Shariah compliance could significantly enhance governance and risk management practices within zakat and waqf institutions throughout the country. The challenge of this implementation is for JAWHAR to maneuver the buy in from each of the SIRCs to identify and design the strategies for risk management and assurance. On the other hand, if the initiatives are performed by each of SIRCs in every state in Malaysia, it is challenging to arrive at a standardized practice, as each SIRCs has its own governance structures and players. This is withstanding to the fact that there are many aspects of Islamic law that could result in a range of accepted practices. The central issue with the divergence of governance

practices is not mainly with the Shariah aspects, but due to the power structure of state SIRCs and central governance.

Methodology

This research aims to explore the Shariah risks associated with zakat and waqf. Two State Islamic Religious Councils with the highest collection and distribution of zakat were selected to provide insights into key Shariah noncompliance risks within their operations. Interviews were conducted on August 22 and August 24, 2024. The interview with SIRC1 included the Chief Finance Officer and the Chief of Internal Audits, while the session with SIRC2 involved an Internal Audit Officer, a Service Department Officer, a Finance and Investment Officer, and the Deputy Manager of Finance. The interviews were facilitated by the Team Lead and an officer from the Professional Practices and Technical Division of the Malaysian Institute of Accountants (MIA). Each interview was scheduled for one hour, following a structured protocol.

Table 1: Interview protocol

	Agenda	**Person in Charge**
1	Introduction of the research focus and deliverables	Prof. Dr. Zurina Shafii
2	Briefing on Key Shariah Noncompliance Risks	Prof. Dr. Zurina Shafii
3	Key Shariah Noncompliance risks in zakat management	Interview Participants
	A. Inflow of funds	
	i. Please identify the activities within the scope of fund inflow for zakat management	
	ii. Please identify SNCs for the activities identified	
	B. Operations:	
	i. Please identify activities and applicable Shariah contracts for the following scopes	
	ii. Please identify SNCs for the activities identified	
	• Governance	
	• Treasury	
	• Marketing	
	• Human Resource	
	• Etc	
	C. Outflow of funds	
	iii. Please identify the activities within the scope of fund outflow for zakat management	
	iv. Please identify SNCs for the activities identified	

Findings and Discussion

For the purpose of the interviews, the definition of Shariah noncompliance risk was adapted from the Shariah Governance Policy Document 2019 (SGPD 2019). This definition refers to the risk of legal or regulatory sanctions, financial loss, or nonfinancial implications, including reputational damage, that an institution may suffer as a result of failing to comply with the rulings of relevant regulators' Shariah Advisory Councils and the respective institutions' Shariah Committee rulings and approvals, as well as applicable acts.

To determine the common areas of Shariah noncompliance risk, institutions must refer to Shariah resolutions, regulations, guidelines, and policy documents pertinent to their specific sectors. In the case of Islamic Financial Institutions, key reference points include Shariah Resolutions in Islamic Finance, Third Edition, 2017; the Takaful Operational Framework from 2019; and relevant policy documents related to Shariah contracts used in offering deposits, financing, investment, and treasury management. Meanwhile, State Islamic Religious Councils rely on enactments and zakat guidelines established by their respective states, as well as resolutions from the Fatwa Council of each SIRC.

From the two interviews conducted, a thematic scope of the common Shariah noncompliance risks for SIRCs was developed based on the insights provided by the interviewees, who are involved in operations and audit as assurance functions within the institutions. The findings derived from this thematic analysis are presented in Table 3.

Table 2: Thematic scope of Shariah noncompliance risks in SIRCs

Financial aspects of operation	**Possible SNCs**
-Zakat collection and distribution (programs for asnafs)	Zakat on business and investments - Incorrect determination of haul, nisab - Incorrect determination of items for calculating zakat base - Incorrect adjustments to derive at zakat base - Wrong identification of asnaf for zakat distribution when institutions distribute on their own
-Asnaf microfinancing -staff financing	Murabahah/Tawarruq contracts - Sequence of transactions not in accordance with Shariah - Inexistence of assets - Inventory risk - Assets do not qualify for murabahah/tawarruq

-Asnaf microfinancing -staff financing	Qard - Should not promise any type of return/benefit or indicative rate of return - System should not allow for preset rate of return for Qard account
-Asset acquisition -staff financing	Ijarah contracts - Ijarah asset and usufructs that is against Shariah rules - Usage of Ijarah assets against Shariah principles - Rental received from assets that does not exist
-Asnaf microfinancing -staff financing	Wakalah - Unauthorized agent that invalidates the contract - Fees charged not in accordance with Shariah principles, e.g., compounding charges
-Financing to subsidiaries -Investment by subsidiaries	Musharakah - Terms or condition of Musharakah contracts contradict Shariah rulings - Sources of capital not from halal sources (in the case of partners who are institutions)
-Financing to subsidiaries -Investment by subsidiaries	Mudharabah - Sources of capital are not from halal sources (in the case of partners who are institutions) - Combination/inclusion of additional contracts resulting in non-permissible products (eg - guarantee by mudarib) - Profit distribution for mudharabah fund is not calculated in accordance to Shariah rules such as weightage assignment; ineligible deduction of expenses.
-Takaful take up for risk management of assets and general takaful for operations	Takaful - Shariah non-compliance risks in takaful include investing in non-halal assets, unclear policy terms (gharar), improper claims handling, and using conventional reinsurance.

Screening of noncompliant business activities	Screening of Shariah compliant investments - Investment in Shariah non-compliant securities
Identification and distribution of tainted income	Purification of tainted income - Incorrect method of purifying tainted income - Investment of tainted income - Comingling of tainted income with halal income - Non-timely purification of tainted income
-Asnaf microfinancing -Staff financing	Back office operations - Tawarruq execution contracts: profit recognized despite delays/non-execution of tawarruq contracts
-Financing to asnaf -Financing to staff	Ta'widh and Gharamah charges - Combined late payment charges exceed average financing rate - Combined late payment charges exceed cost on default - Combined late payment charges compounded on overdue installments - Ta'widh calculated more than 1% - Recognise Gharamah as source of income - Investment of Gharamah received - Capitalization/profit charges on ta'widh and gharamah amount due - Combined principal, profit, and late payment charges more than selling price for tawarruq/murabahah products
-Financing to asnaf -Financing to staff	Ibra' for financing - Incorrect ibra' reduction for early settlement of financing - Improper claim undisbursed principal amount for nondelivery nonpossession of underlying asset
-Financing to asnaf -Financing to staff	Restructuring and Refinancing of Islamic financing facilities (R&R)

	- Inclusion of accrued profit from the original financing as part of new principal amount of R&R - Capitalization of other charges (i.e., late payment charges) that is due

Understanding the Shariah noncompliance risks within State Islamic Religious Councils is the initial step toward adopting comprehensive risk management practices. Once these risks are identified, institutions can engage in risk assessment, mitigation, and monitoring as part of their accountability responsibilities. To effectively address the identified risks, the incorporation of Shariah audits/reviews is essential. These audits/reviews ensure that governance and operational practices align with Islamic principles, particularly in the context of zakat and waqf, which are key mechanisms of Islamic social finance. Proper administration of these funds is critical, especially given the decentralized governance structures among the 14 SIRCs in Malaysia. Each state manages zakat and waqf differently, leading to inconsistencies in governance practices and a lack of uniformity in reporting and auditing.

In the context of SIRCs, Shariah audits/reviews serve as a strategic mechanism for ensuring compliance with Shariah principles in managing zakat and waqf funds. This reduces the risk of fraud and mismanagement. The Shariah audit/reviews process verifies that the collection, management, and distribution of zakat and waqf adhere to established Shariah rules, thereby mitigating financial and operational risks. Based on the findings regarding these risks, several key aspects of Shariah audits can be identified below.

First, auditing//reviewing the collection of zakat and waqf ensures that funds are gathered in accordance with Shariah guidelines. This includes verifying that the sources of donations are halal and free from illegal activities, such as money laundering. Second, Shariah audits/reviews help ensure that the distribution of funds complies with Islamic teachings. For instance, zakat must be disbursed to the rightful recipients (asnaf) based on the categories specified in the Qur'an. Third, the operational costs associated with managing zakat and waqf funds must also adhere to Shariah principles. Audits/reviews are crucial in ensuring that the rights of the amil (zakat administrators) and mutawalli (waqf trustees) are properly respected and applied.

One of the major risk factors in zakat and waqf management is the absence of standardized Shariah audit/review guidelines in Malaysia. In contrast, countries like Indonesia have implemented clear guidelines mandating Shariah audits for zakat institutions. Malaysia currently lacks a similar regulatory framework, increasing the risk of noncompliance with Shariah principles. This gap could undermine public trust in these institutions.

Management of SNCR

The Shariah risk management processes is essential for maintaining the integrity of Islamic philanthropy organizations. By adopting robust governance and risk management frameworks, Islamic philanthropy organizations can navigate the complexities of managing funds while upholding Shariah principles such as waqf, zakat, and sadaqah, as these funds play a crucial role in supporting community initiatives and addressing the needs of zakat recipients. As the field of risk management continues to evolve, further exploration of risk practices in these institutions remains imperative for enhancing their operational resilience and public trust.

In what follows, we outline what actions and steps are required to be taken by philanthropy organizations. They need to apply a range of measures, which include governance structures, compliance mechanisms, Shariah audits/reviews, and continuous training and development. The development of Shariah governance frameworks (SGFs) in philanthropic industry is very important. This will provide the essential requirements for governance. The SGF should provide guidelines for the appointment of Shariah , the creation of a Shariah Compliance Department, the implementation of Shariah Audit/Review, and making sure all stakeholders are responsible to avoid SNCR activities.

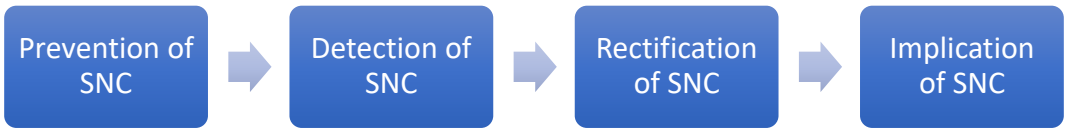
Furthermore, the SGF should include a Shariah committee comprised of qualified scholars who advise, oversee, and ensure compliance with Shariah principles within the organizations. The Shariah compliance department of the organization must work alongside the Shariah committee to monitor and ensure adherence to Shariah principles within organizations. A Shariah audit/review should be conducted on a regular basis to identify and rectify non-Shariah compliance issues. Through Shariah audit/review, Shariah compliance within the organizations will be ensured. This will also maintain the transparent reporting to stakeholders which builds the trust within the stakeholders. All stakeholders from the board of directors, senior management, to junior staff are responsible for avoid SNCR in their respective functions.

In addition, regulatory standards and industry regulations must be developed and adopted. Developing regulatory and industry standards that should be adhered to by philanthropic organizations brings standardization and transparency to the philanthropic industry. A Shariah risk management system should also be created. In Islamic philanthropy, organizations, with the help of Shariah scholars and industry experts, should develop comprehensive risk management systems, including comprehensive Shariah policies and procedures tailored to philanthropy to identify, assess, and mitigate Shariah noncompliance risks.

Training and development mechanisms should be in place for all staff from the board of directors and senior management to junior staff and stakeholders (trustees and managers). It should be ensured that everyone involved in Islamic philanthropy is well-versed in Shariah principles and compliance requirements related financial and operational activities. Finally,

organization should integrate technology into fund allocation and management, including AI and blockchain, etc., to enhance transparency in fund allocation and management. Organizations should implement digital tools to ensure accurate calculation and timely distribution of zakat. By implementing a robust Shariah-compliant risk management framework, philanthropic organizations can ensure ethical operations, maintain stakeholder trust, and contribute effectively to social and economic development within society.

Figure 1 Suggested Framework for Managing SNCR



To manage SNCR, a robust control framework is essential to prevent SNC. Therefore, regulatory guidelines (where applicable) and industry standards must be adhered to for developing SNCR controls, emphasizing the implementation of Shariah rules and principles. According to experts, checklists and control mechanisms are developed and proposed that will be referred to the relevant staff and stakeholders of the organizations.

The second phase (detection of SNC) is to verify the effectiveness of previously established checklists and controls through four functions: Shariah review and audits and regulators' inspections. For Shariah review, the Shariah compliance department should continuously monitor the organization's overall Shariah environment and conduct regular reviews of various type of charity to ensure adherence to Shariah directives and guidelines issued by the Shariah committees. Shariah audits are another layer for monitoring and is different from a Shariah review. A Shariah audit is an independent evaluation examining the effectiveness of internal Shariah controls, governance, and environment to ensure Shariah compliance. It encompasses the entirety of organizational processes, transactions, and entities. Periodically, the regulators inspection team should conduct (where applicable) on-site inspections of organizations to verify compliance with Shariah rules, principles, and regulators' guidelines.

In the above detection phase, the issues identified through Shariah review, audit, and regulators' inspection are presented to the institution's Shariah Committee for recertification. Before providing guidance, the Shariah committee may conduct cross-verification and validation. Cross-verification involves confirming the accuracy of the issues identified in the review or audit reports through reviewing the documents and discussing them with the relevant stakeholders. Research (if required) may be conducted through an internal Shariah team to delve into fiqhi research on the remediation and rectification of identified issues. The nature of SNCR determines the type of impact and remediation accordingly. Finally, the occurrence of an SNC event carries several consequences, such as a regulator's breach, license cancellation,

reputational damage, loss of trustee/donors/public confidence, and financial loss.

Conclusion

In conclusion, this study underscores the critical need to standardize Shariah governance frameworks for zakat and waqf institutions in Malaysia that include the adoption of Shariah audits/reviews as a vital component of their governance frameworks. The findings reveal that implementing Shariah audits significantly enhance accountability and align fund management with Islamic principles, ultimately fostering public trust. Additionally, the absence of standardized Shariah governance frameworks poses a substantial risk, highlighting the need for national-level standards that can ensure consistent practices across the world and particularly in all State Islamic Religious Councils. Future research should focus on the development and implementation of these standardized guidelines, exploring their impact on governance practices within zakat and waqf institutions. Collectively, these efforts can contribute to a more robust framework for addressing Shariah risks in the Islamic philanthropy sector, ensuring that zakat and waqf mechanisms effectively support community development initiatives.

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