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Discharging accountability through governance: Cases from waqf institutions in Indonesia

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ABSTRACT

The ascendancy of Islamic finance particularly its offshoot, Islamic banking has been aggressive considering its spate of development. A salient factor responsible for this is the governing law for such financing paradigm. It is however contestable whether the workability of Islamic banking hinges on dedicated governing laws, amended subsisting laws or existing laws. In other words, is the existing legal (conventional) infrastructure adequate for any Islamic finance jurisdiction, or is there a need for a separate governing law? It is evident that this question is pertinent, vexed and has far-reaching implications. This article seeks to attend to this question in a very concise manner. Thus, the author forms an opinion common-sensibly resorting to comparative analysis, with or without judgements as well as real world country case studies.

Keywords: *Waqf*, *waqf* institutions, governance, accountability

Introduction

Waqf, which is also known as Islamic trust or Islamic endowment is one of the most important institutions that have contributed immensely to the socio-economic and social development since the early days of Islam. *Waqf* can be defined as retaining certain property with the intention of using the benefits for philanthropy act, where there is prohibition of *waqf* assets usage outside of its righteous purposes (Dahlia Ibrahim and Hasnidar Ibrahim, 2013). Cajee (2008) stated that there are growing interest and awareness in *waqf* institutions as one of the tools for the development of community. Indeed, new and modern *waqf* management has put greater emphasize on the principles of accountability and transparency (Cajee, 2008).

The revival of *waqf* institution creates the needs for developing a good governance framework, which could improve transparency and accountability of the institution. The purposes of *waqf* are to provide continuous charity that could generate perpetual income flow for the needy. If good governance is in place, the accountability can be discharge to various stakeholders such as *waqif* (giver) and beneficiaries.

With the establishment of *waqf* institutions, the role of *waqf* in serving society is the main question as many of them is not utilize in providing social services to Muslim society.

Moreover, in some Muslim country, *waqf* properties, have been neglected and therefore it is not surprising if some of the *waqf* properties are not recorded properly or some have gone missing. The situation has called for a better governance for the institutions to encourage their accountability as a *Nazir* (person who is responsible in managing *waqf*) in managing the *waqf* assets.

Ihsan, Ayedh and Shahul (2006) and Cajee (2008) have highlighted that the *waqf* development in the future will largely depend on the good governance of *waqf* institution. In addition, Alias (2012) stated that the directors of *waqf* should be guided by a Code of Governance, and possibly a Code of Ethics. Thus, the directors and trustees would understand their role, ensure the purpose of *waqf* is delivered, effectively working in *shura* (consultative committee), exercise control over the *waqf* assets and behave with integrity and accountability. Masruki and Shafii (2013) also stated that *waqf* institution need to establish a Professional Code of Conduct and a Code of Ethics for *Mutawalli* (trustee), the management and the workers of *waqf* financial industry towards enhancing their accountability. A sound governance system should be in place so that accountability can be discharge to various stakeholders such as *waqif* and beneficiaries. Thus, this study's focus on how the principle of accountability can be achieved through governance process by examining two *waqf* institutions in Indonesia.

The rest of the article is organized as follows. The next section provides background of *waqf* followed by a discussion on accountability. Section 4 discuss on governance and its relation with accountability while section 5 provide the research objective and design of the study. Section 6 and 7 provides the profile of the *waqf* institutions and research findings and discussion, respectively. The paper concludes in Section 8.

Background of Waqf

Waqf is one of Islamic economic instruments to promote the distribution of public wealth. The concept of this perpetual voluntary charity concept is that the underlying asset should remain and the people can take the benefits of the asset. As in the past, the *waqf* sector has the potential to become part of a strong civil society which promotes socio-economic welfare and reduces inequality. Since the *waqf* assets should be in existence in perpetuity, the assets must be managed and administered by the appropriate parties responsible to supervise *waqf* property benefits so that the benefits can be distributed to the recipients.

The charity and alms giving activities are highly appreciated and thus encouraged in Islam. It is understood that *waqf* is one type philanthropic activities in Islam, the same with zakat and *sadaqah*. However, zakat is compulsory, while other types of philanthropic activities (such as *sadaqah* and *waqf*) are encouraged. The perfection of Islam is shown with these great elements of worship. All Muslims activities should be beneficial to society and be directed to get blessing from Allah SWT. Therefore, Muslims also should put aside of their asset for the sake of *ummah*, something that they appreciate and valuable. The assets can be in many forms. The *Quranic* versus in Surah al-Imran is among many verses that indicate the encouragement of the philanthropic activities: "*By no means shall you attain al-birr (virtue, righteousness), unless you spend (in Allah's cause) of that which you love; and whatever of good you spend, Allah knows it well*" (Qur'an: 3:92).

Waqf is a connection between the wealthy and the needy. It can also be collaboration within the society in the environment where everybody (with the same status) aims to contribute to each other even though everybody already able to fulfil their needs and wants. *Waqf* from socio economic aspects can be used as a mechanism to increase standard of living within the *ummah*, reduce poverty and difficulties among the poor and maintaining the good living. This is done through fair wealth distribution among the society (Salarzehi et. al 2010). It can be many types of *waqf*, not limited to religious activities only. The forms of *waqf* are depending on types of assets and purpose of the contribution intended by the contributors. *Waqf* is not limited for religious purpose, but is extended to include several aspects of contributions such as education (school and universities), research, health, housing, orphanage, and centers for unfortunate people etc. This unique characteristic differentiates *waqf* from other philanthropic activities as it can directly fulfil the objectives of the contributors. Looking at the nature of *waqf* institution, it can be either classified as a non-profit organization and social enterprise, consistent with the argument of Adnan (2005). Waqf institutions can be further categorized as an Islamic financial institution based on its decision making process.

In general there are three types of *waqf*, namely, (i) religious *waqf*, (ii) *waqf* for society and (iii) family *waqf* (Kahf, 2000). From the religious purpose of *waqf*, there are few types of *waqf* that have been introduced and expanded. In managing *waqf* assets, the *Nazir* cannot violate the *Shariah* rule (in order to discharge accountability to Allah). In the same time, he should show his accountability in fulfilling *waqf* objectives addressed by the *waqif*. In order to discharge their accountability, a good governance framework must be in practice in order to guide them reaching their goals.

Accountability from Islamic Perspectives

Accountability concept has expanded beyond the basic definition of being called to account for one's actions. It is frequently described as an account giving relationship between individuals. For example, X accountable to Y when X is obliged to inform Y about X's actions and decisions, in order to justify them and to be responsible for any misconduct. As in *waqf*, *mutawalli* or *nazir* is accountable for the management of *waqf* that has been given to him by the *waqif*. Thus, they are responsible in managing the *waqf* to ensure that the benefit from the fund is given back to society.

Accountability is undeniably a core value of a public management as it holds a promise a fair and democratic governance. Unfortunately, many scholars and practitioners claimed that the dissimilarity of accounting practices is due to the absence of accounting standards and code of corporate governance for *waqf*. Ihsan (2007) suggested that the development of accounting standards and code of corporate governance for *waqf* because it could improve the accountability of *mutawalli* in managing *waqf*.

Ibn Umar A.S. says: "Every one of you is a guardian and is held accountable for that which he is entrusted. A rule is a guardian and is held accountable for that which in his care. A man is a guardian in respect of his household, a woman is a guardian in respect of her husband's house and his children. Therefore each one of you is a guardian accountable for whatever is in your care" (Hadith Bukhari and Muslim).

The practice of accountability is highly encourage since the age of Prophet Muhammad S.A.W. Along with the revival of *waqf* institutions has been emerging. The new and modern *waqf* management has out greater emphasize on the principles of accountability (Mikailu & Maishanu, 2013) and transparency.

However, the understanding of accountability may differ to each *mutawalli* due to the different nature of *waqf* to the conventional charity practices. To add that, if there is no clear consensus about accountability for *waqf* institutions, as the means to deliver it will vary. A study conducted by Ihsan (2007) who explored the major themes that constitutes the basis of accountability for *waqf* so that the types of information that should be provided by *mutawalli* to various stakeholders are clearly defined.

Therefore, construction of accountability in *waqf* institutions is much needed especially to ensure the *mutawalli's* accountability. Since *waqf* is charitable, non-profit in nature and a religious entity, the governance process is crucial which is subject to the definition of accountability. Shahul (2000) indicated that Islamic accountability is appropriate for *waqf* due to the religious motive of *waqf* and for *maslahah ummah* (public interest). He suggested that the accountability of *mutawalli* is to be dual in nature; man's accountability to God as Allah's *khalifah* (vicegerent) and man's accountability to men (society). Hence, all human being are being accountable for all resources entrusted to them as well as fulfilling any contract made between them.

Governance and Accountability

Figure 1: Model of Good Governance Framework
Source: http://www.governingtogether.ca

Governance can be defined as "system and process that ensure that the overall direction, effectiveness, supervision and accountability in an organisation" (Cornforth, 2002). The mechanism of governance may comprise governing boards, monitoring systems and signaling mechanism like reporting. The inter-relationship between the governance elements for a good governance framework is shown in figure 1.0. Given the nature of *waqf* institution, it can be classified as a non-profit organization, and social enterprise.

Governance is a very general concept that can refer to all manner of organizations. This means that governance is often defined more narrowly to refer a particular level of governance associated with a type of organization (including public governance, global governance, non-profit governance, corporate governance and project governance), a particular field of governance associated with a type of activity or outcome (including regulatory governance, participatory governance, multilevel governance, metagovernance, and collaborative governance). Governance can be used not only to describe these diverse topics but also to define normative or practical agendas for them. Normative concepts of fair governance or good governance are common among public, voluntary and private sector organizations.

Grindle's (2004) notion of good enough governance has a significant influence on the development thinking of the institutions of global governance. It refers to accepting a more nuanced understanding of the evolution of institutions and governments capabilities and being explicit about trade-offs and priorities in a world in which all good things cannot be pursued at once.

Accountability in governance is basically holding public officials responsible for their actions. It is concerned with the need to ensure that public funds are spent for the purposes specified and without personal gain to any private individual beyond fair compensation for his or her services. Accountability is imperative to make public officials answerable for government behavior and responsive to entity from which they derive their authority while consciously aware of accountability before Allah in the hereafter.

As part of good governance and best practices of *waqf* institutions', accounting is believed to be able to improve the accountability and transparency of *nazir*. Besides, accounting is means of discharging their accountability to many parties such as *waqif*, *waqf* board, government and community. However, *waqf* institutions could depends solely on accounting to discharge their accountability. A solid governance process and structure by the board and management could also enhance the accountability of *waqf* institutions. As *Waqf* institutions can also be categorized as a non-profit organisation, it is useful to adopt set of principles to guide their decision making activities as well as the behavior of the employees, volunteers, and board members. Within an organisation, the principles and practices of ethical accountability aim to improve both the internal standard of individual and group conduct as well as external factors. Based on charity context, Cordery and Morley (2005) proposed the charity accountability as they assume that this sector has specific characteristic compared with business entity. In line with this, Cutt and Murray (2002) agree that accountability framework in non-profit organisations should be define as these institutions have a broad range of constituencies. *Waqf* is not only charitable and non-profit in nature, but also located in religious setting. Therefore, a unique governance process might be implemented in the institutions.

In the context of Islamic Financial Institutions (IFIs), its governance is at the stage of infancy with most of the measures performed internally at the initiative of the management or the industry regulated by the means of guidelines. In fact, *Shariah* compliance reporting at the moment is not corroborated by the external independent parties. For that matter, investors and regulators know little how IFIs management exercises the measures to comply with the *Shariah*. *Shariah* Governance (SG) situated within the domain of corporate governance, which is broadly defined as a set of processes, policies and law that could affect organization's way in being directed, administered and controlled. On top of ensuring a proper framework established in the corporation, IFIs also has the responsibility in ensuring that their operations comply with the *Shariah* principles, including in their products, practices, management and etc. Comprehensive compliance with *shariah* principles would boost confidence to the general public and financial markets on the credibility of IFIs operation. In addition, non-compliance towards *shariah* aspects would expose the IFIs to risks, such as reputational risks and fiduciary risk.

The Accounting and Auditing Organization for Islamic Financial Institution (AAOIFI) is an Islamic international autonomous non-profit corporate body that prepares accounting, auditing, governance, ethics and *Shariah* standards for IFIs and the industry. Its standards are followed as part of regulatory requirement if IFIs internal guidelines. In jurisdictions that offer Islamic finance across Middle East, Asia Pacific, South Asia, Central Asia, Africa, Europe and North America. AAOIFI standards have introduced greater harmonization of Islamic finance practices across the globe. AAOIFI outlines seven principles for governance standards, namely *Shariah* Supervisory Board, *Shariah* Review, Internal *Shariah* Review, Audit and Governance Committee, Independence of *Shariah* Supervisory Board, Statement of Governance Principles and Disclosure for IFIs and Corporate Social Responsibility Conduct and Disclosure. Thus, the difference from governance of conventional and IFIs can be summarized as Table 1.

Table 1. Governance: Conventional vs Islamic Financial Institution

Function	Conventional financial institution	Addition in Islamic financial institution
Governance	Board of Directors	*Shariah* Board
Control	Internal auditor External Auditor	Internal *Shariah* Review Audit External *Shariah* Review
Compliance	Regulating & Financial Compliance Officers, unit/department	Internal *Shariah* Compliance Unit

Source: Islamic Financial Service Board (IFSB): Guiding Principles on Shari'ah Governance System

Governance is focusing on the agenda in all sectors – public, private and voluntary. As the voluntary organizations' main objective is to serve for public benefit, they are expected to demonstrate how well they are governed. Good governance is a vital part of how voluntary and community organisations operate and are held accountable. Other sectors have developed codes over the past decade. For example, the public sector has introduced the Good Governance Standard for Public Services in 2004 and the private sector has its UK

Corporate Governance Code which is continues to be developed in light of recent governance failures.

The original Good Governance: a Code for the Voluntary and Community sector in the UK arose from directly expressed needs in the sector. These needs was addressed from organizations which wanted guidance to clarify the main principle of governance and to help them in decision making, accountability and the work of their boards. Because of the demand, a group of voluntary sector infrastructure associations, with the Charity Commission came together and decided to work towards developing the Code. Therefore the Code was developed by and for voluntary and community organizations. There are six principles that are designed to be universal and applicable to all voluntary and community organization. It is the practice and procedures which will vary according to the type and size of the organization. The six principles are follows: 1) an effective board will provide good governance and leadership by understanding their role, 2) an effective board will provide good governance and leadership by ensuring delivery of organisational purpose, 3) an effective board will provide good governance and leadership by working effectively both as individual and as a team, 4) an effective board will provide good governance and leadership by exercising effective control, 5) an effective board will provide good governance and leadership by behaving with integrity and 6) an effective board will provide good governance and leadership by being open and accountable.

Research Objectives and Design

This study is aimed to examine the governance process in Indonesian *waqf* institutions. Abdul Rahman *et al*. (1999) stated that good governance is needed for the improvement of *waqf* management. The study, hence, proposed for a study that focuses on the structure and management of *waqf* administration. Ihsan (2007) focused on *waqf* accounting in Indonesia *waqf* institutions, however ignoring good governance process towards enhancing the accountability in the institutions. Therefore, this study will focus on good governance by answering these research questions:

1. How is governance process being conducted in Indonesia waqf institutions?
2. Does shariah governance exist in the institutions?

This study investigates two sites to answers the above questions, namely Institution 1 and Institution 2. The research chose these two institutions to be consistent with the study of Ihsan and Ibrahim (2011). The data were collected through interviews from persons who in charge of the management of the institutions and also a director. The interviews focused on the governance of the two *waqf* institutions and last around one hour. To ensure that every statement is recorded, the research interviews were taped. The interviews were held on January 26 until January 29 2014 in selected *waqf* institutions in Indonesia.

Profile of the Selected Waqf Institutions

The first selected institution is Institution 1. Institution 1 was formed by the Yayasan Pesantren Islam (YPI) to develop and manage *waqf* in support of education and *dakwah*. The formation of this body was inspired by the model of *waqf* management in Al Azhar, Egypt. The purpose of the institution is to alleviate poverty in Indonesia besides its vision and mission to return the assets owned by the mortgaged Indonesia. The main *waqf* contributor (*waqif)* of the institution is individuals. Most of them are colleagues of the director of the institution itself. There are no fixed *waqif* in Institution 1 since most of them are individuals who willingly donate *waqf*. To maintain its relationship with the *waqif*, Institution 1 regularly held a joint open fasting with the management company.

Institution 2 is the second institution that was chosen for the study. It was founded in 2004 as described by the Constitution number 41 of 2004. The purpose of the establishment of the institution is to promote and develop the *waqf* in Indonesia in order to manage them professionally that will benefit the *ummah*. Before the law was imposed, *waqf* in Indonesia were managed poorly in a traditional way as they are no specific rules and guidelines emphasizing the management of *waqf*. In regards of the new law, *waqf* are now managed productively by *waqf* institutions to bring forward the national *waqf*. Institution 2 is an independent body that is responsible towards building the Islamic economy in the country.

Findings and Discussions

The findings from Institution 1 and Institution 2 provide some insight of how *waqf* are governed and how far the good governance are practiced in Indonesia *waqf* institutions. As discussed in prior literature, governance is process that could ensure that the overall direction, effectiveness, supervision and accountability in an organization (Cornforth, 2002). One of principles of good governance is the governing boards. The board composition, education background and leadership style could ensure that accountability have being discharge in an institution.

The board of Institution 1 is chaired by a Director and Chief Executive Officer. The appointment of Chief Executive Officer is made on trust basis. The selection is done by the board members based on the board members' perception on whom they believe will be able to lead the organization. Appointment and such recommendations to the main board are made by observing their character and leadership of the persons. Given this scenario, the appointment of the Chief Executive Officer is weakly managed as they only select on trust basis though an element of Islamic CG can be seen through the implementation of *Shura* (i.e. consultation where a group of people votes to elect a leader through a binding decision making process). If this appointment is taken more seriously, a more capable leader could be selected to manage Institution 1. In the future, Institution 1 aims to include the involvement of the institutions members in the appointment of the main board. If the appointed board members do not meet the criteria as a leader, poor management is expected to occur in the future that will also indirectly affect the *waqf* governance in the institution.

Institution 2 consists of Executive Agency and the Advisory Council, each led by a Chairman and two Vice Chairman who are elected by the members. The members of Institution 2 consist of at least twenty persons and a maximum of 30 people from elements of society. The members of Institution 2 are appointed and dismissed by the President of Indonesia. The members are appointed for a term of three years and may be appointed for another one term. Institution 2 has five divisions, *Nazir* coaching, managing *waqf*, public relation and research and development. It cannot be determined who is the regular *waqf* donor at Institution 2. However, *waqif* is able to donate to Institution 2 by visiting the partner bank of the institution as they provide the service as *Nazir* where the public can donate to the *waqf* through their bank. These contributions will be collected and transferred to Institution 2. In Institution 2 there is no special bond to maintain the relationship between the *Nazir* and the institution itself.

In developed economies, auditing is deemed significant because the process of wealth creation and political stability depend heavily upon confidence in processes of accountability, and how well the expected roles are being fulfilled (Sikka, 1998). As such, the courts, regulatory agencies and various stakeholder groups have played their parts in demanding that the profession move in an expeditious fashion to meet its responsibilities as perceived by the public.

For every financial year end, Institution 1 will be audited by an appointed external auditor to show their responsibility in managing the *waqf* fund. Unfortunately, there is no internal audit as they believe it is not required given that their directors are competent enough to manage the institution expertly. Annual budget is prepared relating to distribution and funding *waqf* fund every month. For approval of financing decision, the management must obtain approval from the Director of Finance if the cost is between 1 million Rupiah to 50 million Rupiah. If the amount is above 50 million Rupiah until 100 million Rupiah, they must obtain permission from the Chief Executive Officer.

Similarly, every financial year, Institution 2 is audited by external auditor and government auditor as a means of responsibility for transparency in managing the fund. Institution 2 does not have an internal auditor because the directors are capable and competent in the field of *Shariah* and Islamic Economics. Issues in the spending costs associated with the operations, management must obtain prior approval to the Executive Director. In connection with the program that is already running and to verify whether the program is running well or not, the directors always held a meeting a few times a month. Relating to financial supervision, Institution 2 prepares monthly budget reports on the funding and distribution of the *waqf* funds.

Looking at the corporate governance practice, each institution is audited by external auditor annually but they do not have their own auditor for internal auditing purposes which prove that poor governance is in place. Not only external auditing is crucial but internal auditing is desperately needed to ensure better governance. Though they believe that their board is able to monitor the business, it is highly recommended to hire an internal auditor who specializes in auditing to ensure segregation of duties among each employee not forgetting the employer as well. It is known that segregation of duties will prevent conflicting issues in performing their task as only expert know their job well compared to others. It can be observed, however, that Institution 1 and Institution 2 has a sound internal control in term of usage of money. Both institutions need to gain approval from the board before proceeds with its spending. Boards are being accountable for the decision in the governance process. Budgets are also used by the institutions as a control mean when it comes to funding and distribution of the waqf funds.

As Islamic institutions that handle assets, a sound *Shariah* governance is needed in the institutions to ensure that accountability can be effectively discharged. Institution 1 and Institution 2 have their own *Shariah* board/committee. In Institution 1, *Shariah* board consists of members with doctoral background in both religious and social sphere field. To prevent any deviation in their business against the *Shariah*, the *Shariah* council always consult with Majelis Ulama Indonesia as they are a government agency to refer any fatwa related matters. In the case of *waqf*, the board of directors will refer to the *Shariah* board entering any financial decisions to make sure that it does not prohibited in *Shariah* law. Instead of a *Shariah* board, Institution 2 has a *Shariah* Committee that consists of five members from different educational background. There are committee members with doctoral educational background which are expert in Arabic literature, religion, Islamic Economics and business administration. However, there is no specific *Shariah* Board because all the members are *Shariah* experts.

It is observed that these institutions are govern by *shariah* governance as they believe that it is vital practice for Islamic institutions. They have their own *shariah* board that comprises of different educational background to cater the organizational needs. A current study had identify the issues and challenges in *shariah* governance that relates to *shariah* audit (Abdul Rahim, 2008). He argued that *Shariah* audit is needed to complement the current governance mechanism of the Islamic financial service industry. Thus, it can be concluded that *shariah* audit is indeed important in Islamic institutions that managed assets. However, as discussed earlier, both institutions do not engage in internal audit exercise. On top of that, there are no *shariah* audit procedure perform on the institutions to ensure accountability are being discharged.

Conclusion

Waqf is an important philanthropic institution where it can be utilized to increase the socio-economic of *ummah*. The accountability of the *waqf* management and the involved parties is very high due to the source of *waqf* capital that come from public. The donors put their trust (*amanah*) to management of the institutions and expect their contribution will be managed accordingly to donors' intention. Within this environment, the topic of *waqf* institution governance comes to the picture. This paper examines and compares the governance practices of the two recognized *waqf* institutions in Indonesia. The findings show that there are some degree of differences in the selected governance aspects of the existing structure and practices, such as related to the appointment process of the CEO and higher management and their background of education. In addition, there is no sufficient monitoring mechanism exists in terms of *Shariah* audit in both of institutions, while it is considered as a vital component in Islamic financial institutions worldwide. As such, there are lots of initiatives should be taken especially by the government for this purpose. Future studies should be done on comparison of the *waqf* institutions in Malaysia and Indonesia related to the internal governance mechanism to enhance the management accountability.

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