



Exploring the fraud triangle model and microeconomic factors in zakat embezzlement

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Abstract

Purpose - This study aims to explore the factors contributing to zakat embezzlement, using the fraud triangle theory and a microeconomic perspective to better understand the underlying dynamics in zakat mismanagement.

Method - This study employs a qualitative research methodology, combining a review of relevant literature on the fraud triangle theory and its application to zakat management with thematic content analysis of interviews conducted with two experts in financial corruption and zakat management. The literature review examines academic and industry sources to explore drivers of zakat embezzlement, including opportunities, pressures, and rationalizations. Interviews with a financial management researcher and a zakat management official provide firsthand insights, which complement the desk-based research and contribute to a comprehensive understanding of the issue.

Result - The study reveals that financial pressure, weak internal controls, and rationalization drive zakat embezzlement. The lack of transparency and governance in zakat institutions provides opportunities for mismanagement, while personal financial gain and ethical rationalization further exacerbate the issue.

Implication - These findings suggest the need for stronger governance, better internal controls, and ethical training in zakat institutions. Strengthening transparency and accountability could reduce opportunities for embezzlement, thereby enhancing the effectiveness of zakat as a tool for poverty alleviation.

Originality - This research uniquely applies the fraud triangle framework to zakat embezzlement, integrating microeconomic elements such as utility maximization and information asymmetry.

Keywords: fraud triangle; governance; Islamic social finance; zakat embezzlement

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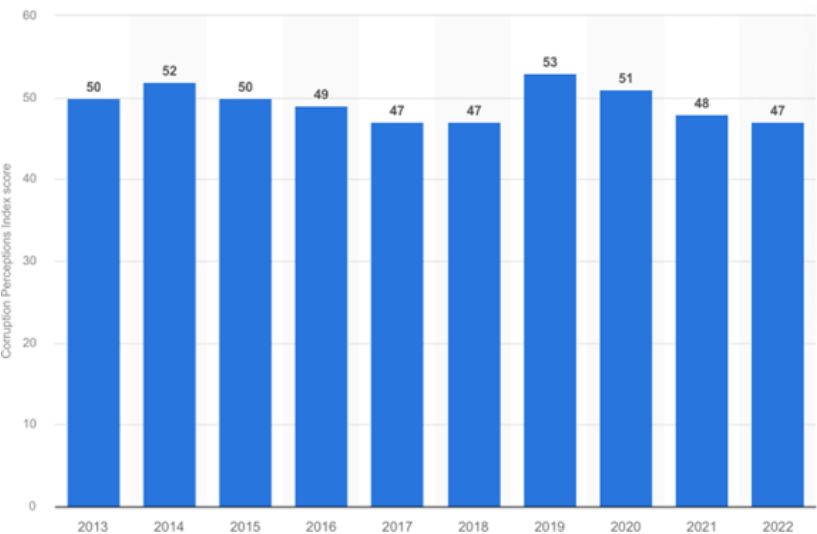
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Introduction

Zakat, a core component of Islamic economics, is crucial for promoting social welfare and income redistribution within Muslim communities. However, the issue of zakat embezzlement has emerged as a significant challenge, undermining the intended socioeconomic benefits of this religious obligation. This paper aims to investigate the factors contributing to zakat embezzlement, drawing upon the fraud triangle theory and a microeconomic perspective.

Zakat is a fundamental religious duty in Islam that is associated with addressing poverty in the community. Research has shown that increased distribution of zakat can lead to a reduction in the frequency, extent, and severity of poverty within the community (Ayuniyyah et al., 2018). However, a concerning trend suggests that mismanaged zakat is leading to higher poverty rates. This issue may be linked to misconduct, such as fraud or embezzlement, in zakat institutions that undermine their effectiveness in managing and distributing zakat which worsens poverty.

Figure 1
Corruption Perception Index of Malaysia from 2013 to 2022



Source: Statista.

The problem of embezzlement within zakat institutions is particularly troubling. Although there has been a slight improvement in Malaysia’s Corruption Perception Index (CPI), corruption is still a big issue, and zakat institutions are not exempted. In 2023, RM9.6 million was reported missing from the zakat collection in Malaysia. Ramli Yoosuf, the director of Bukit Aman Commercial Crime Investigation Department (CCID) said the company was suspected to have failed to deposit the RM 9.6 million zakat collection between March and September (Asyraf, 2024). In August 2024, A member of the

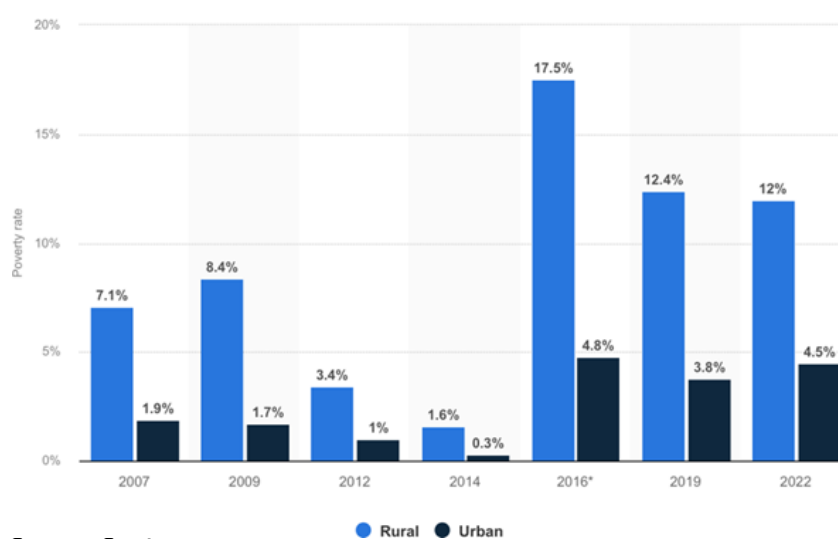
Terengganu Islamic Religious Council and his wife were fined for bribery and false claims related to zakat distribution, with the wife involved in multiple false claims concerning zakat funds (Malay Mail, 2024). The number of missing zakat fund cases will continue to increase if there is no enforcement from the authorities.

Figure 1 shows that Malaysia's Corruption Perception Index decreased from 53 in 2019 to 47 in 2022, indicating a worsening of corruption levels. Concurrently, Figure 2 reveals an increase in the overall poverty rate in Malaysia during this period, despite a decrease in rural poverty, as urban poverty remains persistent. The concomitance between the declining CPI and the increasing urban poverty rate in Malaysia warrants deeper investigation to better understand the underlying factors contributing to zakat embezzlement.

This study leveraged the Fraud Triangle Theory, which examines the interplay of opportunity, pressure, and rationalization, to provide a more nuanced understanding of the phenomenon of zakat embezzlement. The framework illuminates the underlying reasons why individuals employed within zakat organizations may engage in fraudulent conduct, ultimately leading to corruption in the administration of zakat funds. Accordingly, the objective of this research was to analyse the Fraud Triangle from a microeconomic perspective, to gain deeper insights into the misappropriation of resources within zakat institutions. By expanding on this analysis, the researchers sought to uncover the complex web of factors that contribute to the misuse of zakat funds, to inform strategies to strengthen the integrity and effectiveness of zakat management.

Figure 2

Poverty Rate of Rural and Urban Areas in Malaysia from 2007 to 2022



Source: Statista.

Literature Review

The problem of zakat embezzlement has been discussed in various studies. Some scholars have highlighted the significant gap between the ideal performance of zakat collection and distribution, leading to substantial losses of funds that could have positively contributed to poverty alleviation (Wahab & Rahman, 2011). For instance, a report on zakat collection and distribution in Malaysia from 2007 to 2009 revealed that the amount of funds distributed was inconsistent with the amount collected, indicating potential mismanagement or misappropriation of funds (Saad et al., 2014).

The Fraud Triangle model explains why individuals commit fraud by focusing on three key elements: pressure, opportunity, and rationalization fraudulent acts (Wahab & Rahman, 2011; Said et al., 2018; Bin-Nashwan et al., 2020; Tickner & Button, 2021). Previous studies have shown that these factors can be applied to understand fraud and corruption in various contexts, including tax evasion and financial crimes (Mawanza, 2014; Lederman, 2019; Aghghaleh & Mohamed, 2014; Schuchter & Levi, 2015; Mat et al., 2019; Abdo-Salloum & Al-Mousawi, 2023). In the context of zakat embezzlement, the fraud triangle framework can provide valuable insights. These three factors are also common in other fraud models such as Fraud Diamond (Istifadah & Senjani, 2020; Khamainy et al., 2021), Fraud Pentagon (Apriliyani et al., 2024), and Fraud Hexagon (Wijaya & Witjaksono, 2023), where they have positive effects on fraud.

Non-profits like zakat institutions require a strong internal control system to safeguard risk assessment and financial reporting accuracy, protect assets from misappropriation, and minimize fraud (Andraeny and Narulitasari, 2019). Moreover, inefficiency in the zakat management causes weak governance because this type of religious institution is not subjected to specific financial regulations and they are left to deal with internal matters within the highest authorities among them (Hassan & Muneeza, 2022). Weak governance can lead to the emergence of unethical behaviors, such as fraud and mismanagement by untrained workers (Wahyuni-TD et al., 2021). Meanwhile, reputation in zakat institutions is the standard for zakat payers to trust them (Yenti et al., 2022; Sawmar & Mohammed, 2021). Thus, it can be considered that good governance will leave a good impression on the zakat payers meanwhile weak governance will only distance zakat payers from trusting them in their management.

Owoyemi's (2020) study examines trust issues in zakat management, noting that low confidence in zakat agencies leads payers to question whether their contributions reach intended beneficiaries. In this regard, the Fraud Triangle factors could explain the loss of trust among zakat payers when there are cases of zakat embezzlement. Additionally, Setyawigasta et al.'s (2024) systematic literature review identified strategies for mitigating financial statement fraud, such as strong internal controls,

integrity-focused organizational culture, anti-fraud policies, public capacity building, and whistleblowing systems.

From the discussion above, it is evident that fraud and corruption are harmful to zakat institutions, despite the religious nature of their operations. Therefore, this study aims to explore the underlying causes of zakat embezzlement by applying the Fraud Triangle Theory coupled with a microeconomic analysis, an approach that has not been extensively examined in the existing literature.

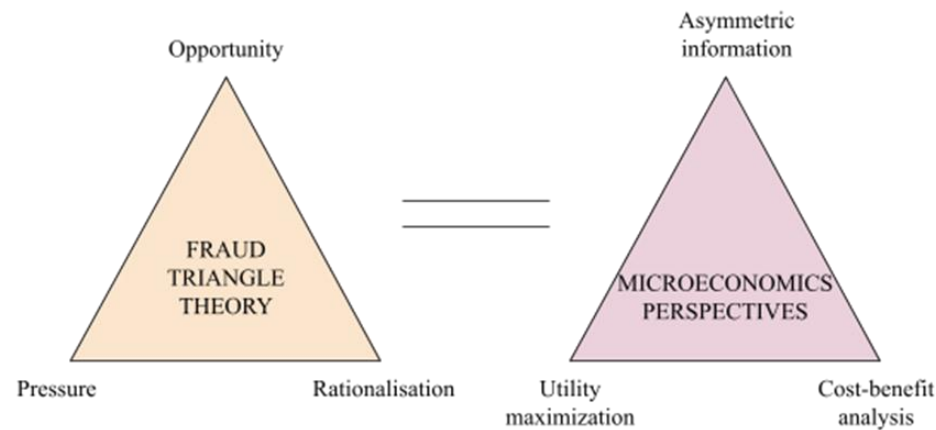
Research Methods

The research methodology involves a review of relevant literature on the Fraud Triangle theory and its application to the context of zakat management. This will provide a deeper understanding of the potential drivers of zakat embezzlement, such as the presence of opportunities, the existence of pressure or incentives, and the ability of individuals to rationalize their actions. The research will draw on a range of sources, particularly academic journals, to provide an insight into the issue. Additionally, the study will explore the microeconomic factors that may contribute to zakat embezzlement, such as the principal-agent problem and the concept of utility maximization. Figure 3 below illustrates a visual representation of the Fraud Triangle theory and its microeconomic perspectives counterpart.

We have also interviewed two experts in the areas of financial corruption and zakat management to gather firsthand insights and validate the findings from the literature review. The first interviewee is a researcher in the area of financial management who spearheads university-level integrity projects with the Malaysian Anti-Corruption Commission (MACC) at a public university in Malaysia. She has 15 years of experience in the financial industry and eight years of experience in academia. The second interviewee is a public university official who is responsible for managing zakat for students' welfare with 34 years of experience. Both interviewees are selected based on their numerous years of experience in managing financial integrity and zakat at a public university. A thematic content analysis was used to review the interview data and extract key information on zakat embezzlement, particularly the factors based on the Fraud Triangle and the recommended actions to address them. The interview data will be used to complement the desk-based research and provide a more holistic understanding of the factors contributing to zakat embezzlement.

Figure 3

Fraud Triangle theory components and its microeconomics perspective



Source: Tickner & Button, (2021) with modifications

Results and Discussion

From a microeconomic perspective, the misappropriation of zakat funds can be viewed as a form of market failure. The presence of information asymmetry between zakat collectors and recipients, as well as the lack of effective monitoring and enforcement mechanisms, can create opportunities for zakat collectors and managers to engage in fraudulent activities.

The application of the Fraud Triangle theory provides a useful framework for understanding the key drivers of zakat embezzlement, including the presence of opportunities, the existence of pressures or incentives, and the ability of individuals to rationalize their actions. Additionally, the Fraud Triangle can be used to analyze the motivations and decision-making processes of individuals involved in zakat embezzlement.

When applied to embezzlement in the context of a zakat institution, the Fraud Triangle model helps to understand how and why such fraudulent activities may occur. The first element of the Fraud Triangle, pressure or incentive element, can manifest in the form of personal financial difficulties, greed, or a desire to maintain a certain lifestyle, which may lead individuals to misappropriate zakat funds. The second element of the Fraud Triangle, opportunity, is often present in zakat institutions due to a lack of robust internal controls, weak oversight, and limited transparency in financial management (Elmaghrabi et al., 2020; Bin-Nashwan et al., 2020). Finally, the rationalization element involves the individual's ability to justify their fraudulent actions, for instance, by perceiving the zakat funds as belonging to the institution rather than the intended

beneficiaries (Said et al., 2018). The interview data further corroborates the findings from the literature review, which are highlighted in each factor below.

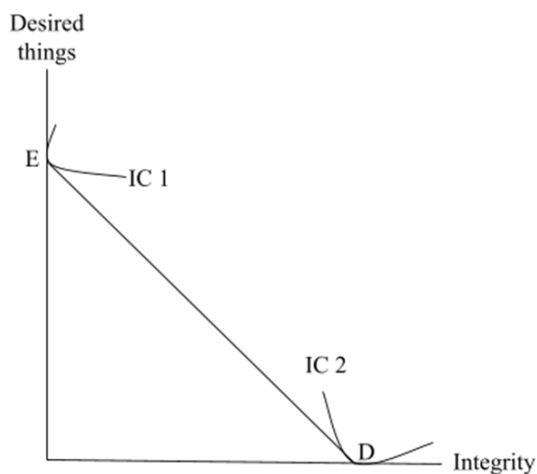
Pressure

The first component of the Fraud Triangle theory is pressure. According to Istifadah and Senjani (2020), individuals in an organization may commit fraud when they face various pressures, such as financial burdens due to low wages or stressful working conditions, as well as external pressures. This research found that some of the motivating factors reported by interviewees were financial burdens and the need to follow their peers, which ultimately stemmed from their financial circumstances. Hence, financial pressure is one of the biggest reasons why someone chooses to commit fraud. However, individuals still have a choice: they can either commit fraud to obtain their desired outcomes or refrain from fraud and forgo those desires. If they prioritize their gains over integrity, they are more likely to engage in fraudulent behavior.

From a microeconomic standpoint, the pressure component of the Fraud Triangle theory can be aligned with the concept of utility maximization. As depicted in Figure 4, if an individual prioritizes obtaining their desired outcomes over all else, they may be inclined to commit fraud to reach the utility-maximizing point E along the higher indifference curve 1. Conversely, if the individual values their integrity more highly than their desired outcomes, despite experiencing pressure, they may choose not to engage in fraudulent behavior and instead end up at the lower but still satisfactory point D. Hence, the individual's rationalization process plays a crucial role in determining whether they will succumb to the pressure and commit fraud or uphold their integrity.

Figure 4

Utility maximization of individual with high risk of committing fraud



Source: Authors' work

From the interviews, zakat institution employees and officials may face various pressures that can motivate them to embezzle funds. Personal financial strain, such as debt, family expenses, or a desire to maintain a certain lifestyle, can drive them to misappropriate zakat funds to alleviate these burdens or accumulate wealth they feel entitled to, even if it harms intended recipients. This is supported by Mustafa et al. (2013) where earning level and personal financial situation can influence zakat payers' trust in zakat institutions. This is consistent with research in other nonprofit contexts, where individuals in positions of authority may misappropriate funds to maintain their influence and status within the organization (Archambeault & Webber, 2018).

Additionally, employees or managers may feel pressured to meet financial targets set by the institution or external factors like community expectations. When they are unable to meet these targets through legitimate means, they may be tempted to misappropriate funds or manipulate records to appear successful, again at the expense of intended recipients (Marks & Ugo, 2016).

Social or familial expectations to maintain a certain lifestyle beyond their means can also prompt individuals to embezzle zakat funds, viewing the institution as a convenient source to relieve their personal financial needs. This pressure can lead them to rationalize their unethical actions, prioritizing their own interests over the sacred trust of zakat.

Opportunity

The second component of the Fraud Triangle theory is opportunity. Opportunity refers to the circumstances that allow fraud to occur. It is a critical aspect of the Fraud Triangle that organizations can influence through policies, procedures, and controls. According to Jan (2021), weak internal controls, such as a lack of segregation of duties and insufficient oversight, create environments where fraud can thrive. Effective internal controls are essential to prevent unnoticed fraud. This includes regular audits, clear procedures, and checks to ensure accountability. Controlling access to assets and information is crucial; restricting employee access through role-based permissions and regular updates can deter fraud. Additionally, simplifying complex organizational structures and enhancing oversight can help expose and deter fraudulent activities.

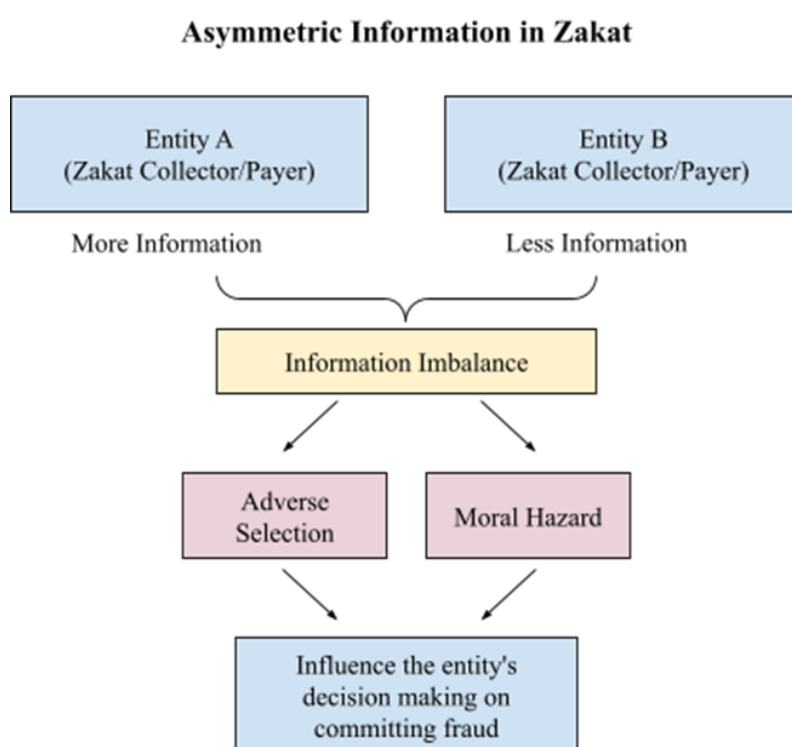
The concept of asymmetric information can be integrated with the opportunity component of the Fraud Triangle theory. Asymmetric information occurs when one party in a transaction has more or better information than the other party. This imbalance can create significant opportunities for fraud, as the party with superior information can exploit the situation to their advantage. Ghafoor et al. (2019) found that asymmetric information increases following fraud announcements in Malaysian firms. This increase in asymmetry leads to higher market uncertainty and reputational

damage, making it more challenging for firms to regain trust and stability. Understanding how asymmetric information influences the opportunity for fraud within the Fraud Triangle framework can be further illustrated in Figure 5 below.

In the context of zakat, asymmetric information can lead to moral hazard and adverse selection, influencing both zakat payers and collectors to commit fraud. Zakat payers might underreport assets or selectively disclose information, believing that zakat authorities cannot fully verify their financial status. This behaviour reduces their zakat liability and exploits the information gap, resulting in dishonest payers contributing less. On the other hand, zakat collectors might misappropriate funds or favour certain individuals based on personal biases, reducing resources for the needy and leading to inefficient distribution.

Figure 5

Asymmetric information in zakat



Source: Authors' work

The Fraud Triangle model also highlights the role of opportunity in facilitating zakat embezzlement. Based on the interviews conducted, weaknesses in the internal control systems of zakat institutions, such as inadequate segregation of duties, poor documentation of financial transactions, and lax oversight, can create opportunities for individuals to misappropriate funds without being detected. When employees or managers have easy access to zakat funds and records, and there are insufficient checks and balances in place, they may be tempted to divert funds for personal gain. Similar to other non-profit organizations, weaknesses in internal controls, such as inadequate divisions of responsibilities and inadequate supervision, can create opportunities for individuals to misappropriate funds for personal benefit (Lenard et al., 2016; Marks & Ugo, 2016).

Additionally, geographical factors and the dispersed nature of zakat collection and distribution can contribute to opportunities for fraud. Zakat institutions that operate in remote or underserved areas may have difficulty implementing robust internal controls and monitoring systems, leaving them vulnerable to embezzlement. This is in line with research indicating that geographic factors, such as an institution's location in remote or underserved areas, can contribute to opportunities for tax avoidance behavior (Chen et al., 2021).

Rationalisation

Lastly, the Fraud Triangle theory includes rationalization as one of its key components. According to Sujeeva et al. (2018), rationalization often precedes and inspires fraudulent behavior. Before committing misconduct or embezzlement, individuals frequently find ways to defend their actions. They can maintain their self-image as reliable people and make sense of their behaviors by using this process of rationalization. In the context of this research and the responses from our interviewees, some employees at the zakat institution may have felt underappreciated or underpaid, and consequently believed they were entitled to a share of the zakat funds received. This conviction serves as a justification for their actions, as they feel they should have benefited in some way from the zakat money and are entitled to a portion of the proceeds due to their efforts in facilitating the efficient collection and distribution of zakat.

This mindset is understandable from a microeconomic perspective when considering the cost-benefit analysis of the employees. People can justify deception by emphasizing the short-term benefits to themselves, such as obtaining luxury items or financial security. They compare these immediate gains to what they perceive as minimal costs, especially if they believe the fraud is small-scale or necessary to further a

greater good. Their denial of the potential repercussions and conviction that the fraud does not harm anyone further allow them to rationalize their behavior.

The final element of the Fraud Triangle, rationalization, is also crucial in understanding zakat embezzlement. Individuals may rationalize their actions by convincing themselves that they are entitled to the funds, that the institution can afford the loss, or that their actions will not significantly harm the intended recipients. Rationalization occurs when individuals justify fraudulent or corrupt actions through the adoption of self-serving beliefs or narratives (Zahari et al., 2020).

A weak organizational culture that fails to instill a strong sense of ethical behavior and accountability can enable individuals to more easily rationalize their actions (Ghani et al., 2021). Inadequate ethical training and a lack of emphasis on the importance of zakat as a sacred trust can contribute to a mindset where individuals feel justified in misappropriating funds for personal gain.

Individuals may rationalize embezzling zakat by believing they deserve the funds due to personal financial needs or a perception of low pay. The Fraud Triangle highlights rationalization, which allows people to morally justify their fraudulent actions (Ismail & Bernawati, 2019).

Zakat officials may view the funds as an impersonal resource that can be tapped without directly harming intended recipients. They may convince themselves that the impact is minimal or that the institution or recipients can absorb the loss. Some may rationalize that diverting a small portion will not significantly affect the poor or that the institution collects enough to cover the loss. According to the interviews, if employees perceive the institution as mismanaged, corrupt, or unfair, they may rationalize stealing as retaliation or compensation for these perceived injustices.

Policy Recommendations

To address the issue of zakat embezzlement, a combination of strategies can be implemented. It is crucial to strengthen institutional controls, transparency, and accountability measures to deter fraud (Wahyulistyo & Cahyonowati, 2023; Said et al., 2018; Nadhirin & Husnurrosyidah, 2018). This can be achieved through regular audits, segregation of duties, and robust record-keeping practices. Additionally, enhancing religious education and ethical training for zakat collectors and administrators can help instill a stronger sense of integrity and responsibility, reducing the likelihood of rationalization.

Furthermore, improving the remuneration and working conditions of zakat personnel can alleviate financial pressures, minimizing the temptation to commit fraud. Increased oversight and monitoring of zakat distribution, along with clear

communication and feedback mechanisms, can also help address information asymmetry and build trust with the public.

Based on the interviews, religion has been proposed as the best way to enhance internal self-control against fraud. Religion plays a crucial role in reducing fraud tendencies by promoting ethical behavior and moral values among individuals (Nadhirin & Husnurrosyidah, 2018). Several studies have examined how religious beliefs and practices influence the propensity for fraud and other unethical activities, particularly within financial institutions like zakat and other Islamic finance entities. Religiosity has a negative impact on employee fraud although other elements in the Fraud Triangle Theory had positive relationships (Said et al., 2018). Similarly, Istifadah and Senjani (2020) found that religion could function as a moderating factor to restrain fraud tendencies. Through data analysis, they revealed that high religious awareness will moderate each element of the Fraud Triangle Theory. Religion could be one of the ways to solve integrity issues which are associated with committing fraud (Nor Paizin, 2021) and serve as a mitigation to corruption (Ismail & Bernawati, 2019). At the same time, Islamic religiosity has been highlighted as one of the elements that can prevent a person from committing fraud.

Besides religion, there are six possible strategies to address zakat embezzlement based on our interviews. First, the incorporation of zakat institutions as reporting agencies under Anti-Money Laundering (AMLA) regulations would enhance transparency and accountability. Requiring zakat institutions to adhere to stringent reporting and monitoring requirements would significantly deter the misuse of funds. This would involve implementing robust financial reporting standards, regularly submitting detailed financial statements, and subjecting the institutions to rigorous external audits. This strategy is parallel to Nasir's (2018) recommendation to include Islamic financial institutions under AMLA and combating financing terrorism (CFT) regulations. Second, zakat institutions should enhance transparency through regular audits, public disclosure of financial records, and the involvement of independent oversight. This would increase scrutiny and build public trust in the management of zakat funds. Additionally, the involvement of independent oversight bodies would increase scrutiny and monitoring of zakat fund management, discouraging potential embezzlement (Sawmar & Mohammed, 2021).

Thirdly, strong leadership and oversight from managers within zakat institutions is crucial (Sawmar & Mohammed, 2021). Managers should ensure that workers operate within their assigned roles and responsibilities, maintain integrity, and avoid any actions that could be construed as embezzlement or fraud. Fourthly, providing zakat collectors with comprehensive training and ethical education programs, emphasizing the

importance of honesty, fairness, and social responsibility in zakat distribution, can help cultivate a culture of integrity and discourage fraudulent behavior.

Additionally, employers should hire workers with not only a strong Islamic background but also solid management expertise. This would enhance the progressive and efficient administration of zakat funds, as well as facilitate seamless operations. This strategy reflects Hasan et al., (2019)'s view that the skills and expertise acquired by zakat collectors enable them to manage the collection and distribution of zakat in a fair and efficient manner, while also facilitating public awareness and understanding of zakat payment. Finally, the government and zakat institutions should collaborate to create tailored solutions that guarantee the smooth collection of zakat, ensure the openness of distribution and collection procedures, and maintain the integrity of the entire zakat system.

Conclusion

Embezzlement within zakat institutions is a critical issue with substantial implications for poverty alleviation. The research findings highlight the complex and multifaceted nature of zakat embezzlement, with a range of factors contributing to this issue from both organizational and individual perspectives. From a microeconomic perspective, the Fraud Triangle theory helps explain how factors such as pressure, opportunity, and rationalization can contribute to employees engaging in fraudulent activities. The application of the Fraud Triangle theory provides a useful framework for understanding the key drivers of zakat embezzlement, including the presence of opportunities, the existence of pressures or incentives, and the ability of individuals to rationalize their actions. Opportunities for fraud arise from asymmetric information and lack of oversight, while financial pressures and peer influence motivate individuals to commit fraud, and rationalization helps them justify their actions.

The findings suggest a multifaceted approach is needed to address zakat embezzlement. Key strategies include strengthening governance and transparency in zakat institutions, enhancing ethical training and integrity for zakat collectors, and improving the regulatory environment to deter fraud. Specific measures to mitigate embezzlement should focus on bolstering institutional controls, promoting transparency and accountability, providing ethical and religious education, and improving employee compensation and working conditions.

The research identified the key factors contributing to fraud in zakat institutions using the Fraud Triangle framework. However, there are some limitations to this research. Note that other variations of fraud theory, such as the Diamond Fraud Theory and Hexagon Fraud Theory, include additional components in their analysis. Future research should consider these factors for a more comprehensive understanding of

fraud in zakat institutions and expand the list of relevant microeconomic concepts. Understanding these factors through a microeconomic perspective is essential for developing strategies to improve the integrity and efficiency of zakat administration, thereby enhancing its effectiveness in reducing poverty.

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