



# Institutionalization of risk management framework in Islamic NGOs for suppressing terrorism financing

## Exploratory research

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### Abstract

**Purpose** – The aim of this paper is to propose solutions for improving internal controls and transparency to alleviate concerns of international community over alleged linked with terrorist groups.

**Design/methodology/approach** – The authors explore the counter-insurgency theory and political process model to explain the current state of counter-terrorism activities aimed at Islamic NGOs after 9/11.

**Findings** – The authors believe the idea of money flow disruption to be of greater importance than freezing the accounts to suppress terrorism financing.

**Practical implications** – Islamic NGOs established for philanthropic and humanitarian aid in third world Muslim countries have been accused of being involved in terrorism financing. This revelation is to the disadvantage of the donors who do not channel their donations for such activities. The authors propose risk management framework useful at operational level to detect and prevent welfare activities financing warfare activities.

**Originality/value** – The proposed risk management framework is to complement various regional and international initiatives championed by Asia/Pacific Group on Money Laundering and Financial Action Task Force to combat money laundering and terrorist financing.

**Keywords** Risk management, Internal control, Islamic non-government organization, Terrorism financing

**Paper type** Viewpoint



### 1. Introduction

In most of the developing countries, NGOs are seen as addressing the issues of development and poverty. Most of the services provided by these organizations include childcare, healthcare, adult literacy, social welfare and other services that some governments are incapable of providing. Some NGOs are purely of foreign origin, while in third world countries some are local but funded from abroad (Jamil, 1998). Foreign NGOs have also been active in relief and rehabilitation work in natural disasters. NGOs with a humanitarian and social justice focus are seen as helping ethnic minority

and economically disadvantaged groups. It cannot be disputed that NGOs play a vital role in supplementing the service delivery functions of some governments. However, there have been many instances when these organizations have been exploited by terrorist groups as a method to finance their activities. Terrorist organizations and political insurgents could use NGOs as a tool to move community members along a “continuum of community support” toward greater acceptance of and participation in violent activities (Flanigan, 2006). In the aftermath of 9/11, on 28 September 2001, the US President passed executive order 13224, freezing the assets of individuals and charities suspected of being linked to terrorism (Cole, 2003). This executive order clearly states that foreign persons are to be determined by the Secretary of State, in consultation with the Secretary of the Treasury and the Attorney General, to have committed, or to pose a significant risk of committing, acts of terrorism that threaten the security of US nationals or the national security, foreign policy, or economy of the USA. The UN also passed Resolution 1373 under Chapter VII of the Charter asking the member states to refrain from providing any form of support to terrorist groups, and to implement measures to suppress terrorist acts within their jurisdictions. These include enhanced financial and border controls and international judicial cooperation, among others (Humanitarian Policy Group (HPG), 2011).

The current discourse on the “war on terrorism” has conflated nationalist issues, with Islam being blamed for the violence. For instance, much of the political violence in countries such as Thailand, the Philippines and India to name a few are old-fashioned nationalist or ethnonationalist movements (Acharya, 2009). Though these conflicts predate September 2001, national governments who have failed to find a solution have used Islam as a scapegoat. It is misleading to portray Islam as an undivided whole and those who choose to be Muslims as adherents of a homogenous worldview (Kadioglu, 2005). Liberal and community oriented views espoused by NGOs coexist within Islamic societies and at times confront radical terrorist groups. In this paper, first, we explore the counter-insurgency theory and political process model to explain the current state of counter-terrorism activities aimed at Islamic NGOs. Islamic NGOs are of considerable concern for US counter-terrorism operations (Bloodgood and Tremblay-Boire, 2011). We briefly discuss the US Government primacy over such operations which tend to send the message of local organizations’ incapability of detecting NGOs’ financial assistance to terrorist groups (Tovo, 2006). Prior studies on the financing of terrorism document that it has been accomplished through legitimate business. Since the 9/11 attack, Islamic charities have faced increased scrutiny over alleged links with extremist groups. The USA has tried to identify charities engaged in facilitating “terrorist” activities and to cut off funds channeled through them (Benthall, 2003). Islamic charities are considered particularly suspect as fronts or conduits for terrorist financing through mobilization of financial resources using informal banking systems and religious traditions of *Zakat* and *Sadaqah* (Hardister, 2003; McCulloch and Pickering, 2005; Sproat, 2005). Indeed, the Financial Action Task Force (FATF, 2002) argues that community solicitation and fundraising appeals have been used as effective means of raising funds to support terrorism.

Second, we propose an accountability regime for NGOs, to first detect and then prevent the welfare activities of Islamic NGOs becoming warfare activities. Although we do not empirically test whether new risk measures would reduce the likelihood of, or damage from, terrorism we believe that it is a new contribution to ongoing measures

to suppress terrorism financing. We believe that there is little research exploring the idea of the disruption of the money flow to be of greater importance than freezing the accounts to suppress terrorism financing.

## 2. Counter-insurgency theory, political process model and counter-terrorism activities

The ideological antecedents of counter-terrorism lie in counter-insurgency theory and practice which was originally developed by the French and British military in the face of nationalist struggles to overthrow colonial rule (McCulloch and Pickering, 2005, p. 472). According to Hocking (2004, p. 71), counter-terrorism provided a domestic peace-time adaptation of strategies for "war against terror" after the end of Cold War. Lum *et al.* (2006) report that in 2005 the Congressional Budget office estimated that since 1998 the financial resources appropriate to combat terrorism has increased from US\$7.2 billion to \$88.1 billion while homeland security funding has risen from \$9 billion in 2000 to \$32 billion in 2005. The use of these resources has led to setting up of organizational structures empowered to direct interagency counter-insurgency tasks in several jurisdictions, without even the knowledge of sovereign states. Counter-terrorism laws have developed at different paces in different jurisdictions. The USA is a special case. In this regard, the two most relevant sanction regimes in the USA are: the Department of the Treasury Office of Foreign Assets Control (OFAC) and the Material Support Statute in US criminal law because these have the greatest potential adverse impact on humanitarian organizations (HPG, 2011). OFAC is the lead office responsible for implementing sanctions with respect to assets of international terrorist organizations and terrorism supporting countries. It focuses on identifying persons for designation; assisting parties in complying with the sanctions' prohibitions through its compliance and licensing efforts; assessing civil monetary penalties against the persons violating the prohibitions; and working with the other US Government agencies. As of 31 December 2011, assets blocked pursuant to Executive Order 12947 and 13224 and 18 U.S.C 2339b (a)(2) totaled \$25,528,389 (OFAC, 2011).

We argue that contemporary "counter-terrorism" practices are associated with the surveillance over NGOs due to their ties with terrorist groups. The US Government has intensified surveillance through its diplomatic, cultural, educational and social agencies such as USAID and pressures on supernatural organizations such as the International Monetary Fund (IMF). For instance, USAID partner vetting requirements envisage collecting and reporting information about partner and contractor staff to the US Government which has been dubbed as invasive and accusatory by partners (HPG, 2011). Many counter-terrorism measures taken after 9/11 against the Islamic NGOs that pose a threat to the West can be characterized as reminiscent of the coercive strategies of an earlier colonial period and can be characterized as neo-colonial.

Terrorism refers to the deliberate reckless killing of civilians, or to the doing of extensive damage to their property, with the intention of spreading fear among communities and expressing discontentment or angst (Macrae and Harmer, 2003). Economic theory identifies terrorists as rational actors who use violence as a means to achieve political goals. According to McAdam's (1982) political process model, insurgencies (terrorists) mobilize not only because people harbor grievances of some kind, share their grievances with others, and together can do something about them, but they also need to have access to sufficient resources and networks of potential members

and organizations. As the broader political environment becomes “open” to insurgency formation, insurgencies mushroom into terrorist groups. In many cases, political opportunities have manifested themselves in three broad forms:

- (1) political instability;
- (2) enhanced political position of the aggrieved populations; and
- (3) ideological openness (Everton, 2011).

Newman (2006, p. 751) identifies poverty, social inequality and political grievances, among others, as key preconditions that set the stage for terrorism. Akyuz and Armstrong (2011) propose that social disorganization theory provides a useful framework for understanding the social-structural correlates of terrorism.

From the above theoretical discussions, we predict that an extremist group such as Al-Qaeda emerged from the ruins and political instability in the aftermath of the Afghan Soviet Union war. The group mobilized Islamic NGOs in the guise of Islamic social welfare to support its war (Jihad) against the West and the USA in particular. Terrorist groups such as Al-Qaeda and radical ideologues are using Islamic ideology to galvanize the wider Muslim community not only into committing violence but also for garnering financial and logistical support. NGOs were used to channel funds, resources, supplies and recruits for Al-Qaeda. Al-Qaeda relied extensively on the network of NGOs that were established at the height of the Soviet invasion in Afghanistan in the 1980s. Al-Qaeda has realized early on the effectiveness of using NGOs for their own nefarious objectives and they expanded their network in Southeast Asia by setting up NGOs, and even legitimate business, in Indonesia and the Philippines. According to Asia/Pacific Group on Money Laundering (APG, 2007, p. 21), this region’s payment and remittance sector is significantly informal, predominantly serving low income and illegal immigrant populations in particular, and therefore not subjected to AML/CFT controls and may be vulnerable to misuse for money laundering and terrorist financing. To their advantage, informal banking systems operate with complete legitimacy in many developing countries. These systems have been sustained in Asia and Africa because of the high level of trust. *Hawala* is one of the main informal international remittance services. In July 2001, the Saudi Ministry of Information announced that all NGO are banned from sending funds abroad. Such measures come with costs that will be borne by the supposed beneficiaries of the NGO. On 7 October 2011, Al Barakaat, the largest alternative remittance company offering *Hawala* in the USA, was added to list of suspects as a conduit for terrorist funds. Post 9/11, the USA clamped down on *Hawala* service providers in the USA, freezing their assets. Financial institutions began to be deeply concerned by countering money laundering and terrorism financing (Favarel-Garrigues *et al.*, 2011; Irwin *et al.*, 2012; Patrick, 2009; Ungar, 2007).

There have been claims that *Zakat* and *Sadaqah* have been used as resource mobilization vehicles for terrorism financing. The Islamic voluntary sector has seen an immense increase in the number of voluntary organizations in the aftermath of 9/11 and the Iraq war; Muslims have been urged to help their Muslim brothers in the war affected areas. *Zakat* (alms giving) in Islam is not an arbitrary charity nor a supererogatory donation handed out according to each benefactor’s wish. On the contrary, it is an obligatory (*fard*) act decreed by God Himself (Senturk, 2007). *Sadaqah* is a non-obligatory or optional payment that is totally at the discretion of the Muslims. It is not subject to the rules governing *Zakat*. A substantial amount of money is collected

worldwide annually through *Zakat* and *Sadaqah* in Southeast Asia (Ariff, 1991). *Sadaqah* represents an important source of funds available to the Islamic voluntary sector, as Islam exhorts its followers to pay *Sadaqah* as much as they can. Thus, theoretically, there is no limit to *Sadaqah* collections unlike *Zakat* which is paid annually by the Muslims based on their wealth. It would be unsettling then to those who would not want to believe, that some of these organizations would use their *Sadaqah* and *Zakat* to fund terrorism operations. The US Government persuaded Saudi Arabia, one of the largest donors to developing countries, to bring about stricter measures on public fundraising activities, including the ban on charity collection boxes in mosques and closing down some NGOs suspected of being fronts for terrorist groups. In a civil case brought against the Holy Land Foundation for relief and development, then the largest charity in the USA, the charity was found guilty by a US court of supporting Hamas through its contributions to West Bank *Zakat* committees. This charity was dissolved and its directors were given sentences of up to 65 years in prison (the case is currently under appeal (HPG, 2011)).

The number of suspected Islamic NGOs and humanitarian relief organizations has increased over the years under executive order 13224 which might have altered potential donors' way of thinking. There has been a noted decrease in the fundraising income of legitimate Islamic NGOs since the 9/11 attacks. The scale of the US Government involvement in suppressing the financing of terrorism by targeting NGOs suspected of terrorism financing, goes beyond its borders. This approach has been seen as ostensibly overarching and intruding into the national policies and financial systems surveillance of other countries (Hardister, 2003). According to Zagaris (2002), counter-terrorism surveillance of such NGOs from Somalia has significantly affected the aid programmes in the country. According to HPG (2011), a significant drop has been attributed to the fear of donors falling foul of strict efforts by the USA to monitor terrorist financing. For example, the funding has declined by half between 2008 and 2011, mainly as a result of a drop in US contributions, and humanitarian organizations are being asked to introduce extensive risk mitigation measures. It is ironic that attempts to close down or control formal NGOs have had precisely the opposite effect by forcing charitable giving into less unregulated channels. Bloodgood and Tremblay-Boire (2011) suggest that NGOs, particularly international NGOs (INGOs) operating in multiple countries affected by the new transnational terrorist threat, would respond similarly to protect their interests. A common response would enable coordination among international NGOs and a stronger global campaign to fight counterterrorism laws, with negative consequences for civil society. The 9/11 opened a new era, with considerable anti-terrorist financing action and dramatic reinforcement of the counter money laundering fight. Terrorist activities would not exist without funding. In response, various regional and international initiatives have been introduced to suppress terrorist financing, as presented in the next section.

### 3. Regional and international initiatives for suppressing terrorism financing

The Asia/Pacific Group on Money Laundering is an autonomous and collaborative international organization, committed to the effective implementation and enforcement of internationally accepted standards against money laundering and financing of terrorism. One of its functions is to assess compliance by Asia/Pacific Group on Money

Laundrying members with the global AML/CFT standards through a robust mutual evaluation programme and the provision of recommendations on how certain aspects of the system could be strengthened. It has 41 members and five observers. In addition, 24 international organizations participate in Asia/Pacific Group on Money Laundering work, including FATF, FATF-styled regional bodies (FSRBs), the IMF, the World Bank, the Asian Development Bank, the Egmont Group, the Group of International Finance Centre Supervisors, and the United Nations office on Drugs and Crime as well as the UN.

Asia/Pacific Group on Money Laundering also looked into the administration and management of religious institutions responsible for *Zakat* and *Sadaqah* in member countries. The Malaysian Government has been commended for having good infrastructure for *Zakat* and *Sadaqah* collection and distribution (APG, 2007). For instance, *Zakat* is tax deductible in Malaysia, and so the payment can be traceable to the payers. The *Zakat* offices maintain a database of *Zakat* payers and the Inland Revenue Board also keeps the records of *Zakat* payers. The Federal Government Department of Islamic Development Malaysia (JAKIM) issues best practices in *Zakat* collection and distribution procedures. Similarly, the Brunei Islamic Religious Council (MUIB) has the authority over the management of collection and distribution of *Zakat* under the Islamic Religious Council Act and Kadi Courts Act (ss114 to 121). In contrast, Indonesia does not have a centralized system of *Zakat* management and the vast majority of *Zakat* is given at the village level directly to the mosques or to organizations related to the mosques. The *Zakat* regime appears to cover only about 10 percent of the total *Zakat* organisations operating in Indonesia, the vast majority remaining unregulated. Also, the Indonesian authorities do not have accurate statistics on the number of *Zakat* related associations or other types of *Zakat* non-profit organizations (NPOs) operating in Indonesia (APG, 2008). From these case studies, it is clear that authorities must increase their oversight and emulate the best practices in their region.

The FATF is an inter-governmental body established with the mandate to set standards and to promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and the financing of proliferation, and other related threats to the integrity of the international financial system. The FATF's 40 recommendations and nine special recommendations set out a comprehensive and consistent framework of measures which member countries should implement through measures adapted to their particular circumstances. Special recommendation II covers criminalizing the financing of the terrorism and associated money laundering, and recommendation V covers the international cooperation in relation to the financing of terrorism, terrorist acts, and terrorist organizations (Johnson, 2008). FATF (2013) defines a NPO as a legal person or arrangement or organization that primarily engages in raising or disbursing funds for purposes such as charitable, religious, cultural, educational, social or fraternal purposes, or for the carrying out of other types of "good works". However, NPOs should ensure that they cannot be misused by terrorist organizations posing as legitimate entities, nor conceal or obscure the clandestine diversion of funds intended for legitimate purposes to terrorist organizations. FATF (2013, pp. 54-55) suggests that the measures adopted by countries to protect the NPO sector from terrorist abuse should not disrupt or discourage legitimate charitable activities. The measures should promote transparency and engender greater confidence in the sector and avoid any negative impact on innocent and legitimate beneficiaries of charitable activity.

Some of the measures proposed by FATF (2013, pp. 56-57) are as follows:

- (1) NPOs should maintain information on:
  - the purpose and objectives of their stated activities; and
  - the identity of the person(s) who own, control or direct their activities, including senior officers, board members and trustees. This information should be publicly available either directly from the NPO or through appropriate authorities.
- (2) NPOs should issue annual financial statements that provide detailed breakdowns of incomes and expenditures.
- (3) NPOs should be licensed or registered. This information should be available to competent authorities.
- (4) NPOs should have appropriate controls in place to ensure that all funds are fully accounted for, and are spent in a manner that is consistent with the purpose and objectives of the NPO's stated activities.
- (5) NPOs should follow a "know your beneficiaries and associate NPOs (includes foreign branches of international NPOS)" rule, which means that the NPO should make best efforts to confirm the identity, credentials and good standing of their beneficiaries and associate NPOs. NPOs should also undertake best efforts to document the identity of their significant donors and to respect donor confidentiality.
- (6) NPOs should maintain, for a period of at least five years, records of domestic and international transactions that are sufficiently detailed to verify that funds have been spent in a manner consistent with the purpose and objectives of the organization, and should make these available to competent authorities upon appropriate authority. This also applies to information mentioned in paragraphs (1) and (2) above.
- (7) Appropriate authorities should be able to apply effective, proportionate and dissuasive sanctions for violations by NPOs or persons acting on behalf of these NPOs.

In the next section, we propose an institutionalization of risk management framework at the NGO level, to enhance transparency and build trust in NGO leadership, which would mitigate the likelihood of these organizations falling victim to terrorists' scams and the freezing of their assets in foreign jurisdictions.

#### **4. Risk management issues in Islamic NGOs**

NGOs are very sensitive to inquiries and investigations made against them by government and the current measures in place are not enough to make them account for their activities and how they spend their funds. Lack of staff with accounting backgrounds, no clear ownership interest, and no clear established objectives: these are some of the main reasons for NGOs not being able to control their operations in the most transparent manner. Even though in some countries the law requires NGOs to furnish accounts and financial statements, cases of non-compliance are numerous and the authorities in the developing countries are normally handicapped with limited manpower to chase the perpetrators. This unfortunately provides a good opportunity for NGOs to

keep straying away from their accountability as long as they can and provides opportunity together with motive and rationalization, leading to fraud and concealment of their intentions. Zack (2003, p. 8) highlights that fraud can be committed in three ways: by, for and through NGOs. Frauds by NGOs are schemes carried out by insiders on behalf of the organization, often involving the collaboration of several individuals within the organization. For instance, deceptive fundraising activities especially on what portion of the proceeds will be used in an organization's charitable program, can sometimes mislead the public. Frauds for NGOs are fraudulent or abusive acts carried out by insiders with the intent of benefiting the organization, such as a fundraiser misleading a donor into believing that the donation is tax deductible more than what is allowed. Frauds through NGOs occur where insiders abuse their position of trust or use information to which they are privy in order to carry out frauds against outside parties. If frauds are committed for terrorism financing and money laundering, the country in which the charities are operating might be criticized and accused of condoning such activities.

At the country level, all NGOs should be properly regulated to reduce the risk of misuse. Regulations direct behavior, helping to produce convergent expectations and practices and reduce uncertainty in the future (Bloodgood and Tremblay-Boire, 2012). At the very least, there must be proper procedures requiring NGOs to register with relevant government agencies and to comply with government regulations in order to benefit any tax exemption eligibility. Government agencies or departments must be aware of their activities and require periodic reporting from these NGOs. However, in reality there are significant differences across Muslim countries in terms of regulations and oversight and, as a result; voluntary sectors might be under-regulated. For instance, Indonesia is one of the populous Muslim countries. It has two primary legal forms of NGOs: associations and foundations. It is believed that a large number of these organizations exist in a quasi-legal state, and are not legally established as foundations or associations. There is no single body overseeing the operations of these organizations. For instance, ordinary associations are regulated by the Ministry of Law and Human Rights, international NGOs are regulated by the Department of Foreign Affairs, and social welfare NGOs are regulated by the *Departemen Sosial*. In Malaysia, NGOs may be formed either as a charitable corporation or as societies/associations. The former are regulated by the companies commission, the latter by the registrar of societies. We argue that having several distinct bodies to oversee the voluntary sector has hampered actual enforcement of laws and regulations, leading to incomplete oversight of such organizations.

At the operational level, we propose that Islamic NGOs should establish and continuously improve their risk management. An NGO is as susceptible to the dangers posed by potential risks as its counterpart: the for-profit business community (Matan and Hartnett, 2011). Matan and Hartnett identify the six most common areas that have a high potential for risk: special events and other fundraising risks; volunteer risk; financial risk; staffing risk; restricted grants risk; and reputation risk. A brief description of each risk and our proposal on how these risks can be mitigated is as follows.

*(a) Special events and other fundraising risks*

Special events and fundraising activities must be mission appropriate (Matan and Hartnett, 2011). If an NGO decides to use the service of brokers and commercial fundraisers, their background must be checked to make sure that they are not linked to



terrorist organizations. This is especially important if the fundraising activities are conducted in foreign countries where the NGO does not have physical offices. International public funding must get approval from the regulatory department or agency. If there is no such procedure in a certain country, it would be good to notify them of such intentions. The flow of funding should go through proper financial institutions which are subjected to tight regulation on money laundering and controls. It might be good practice to communicate to the brokers or commercial fundraisers that the appeal expenses should not exceed, for example, 30 percent of the total funds raised. Proper records and accounts must be properly maintained and audited. For instance, a statement of accounts for international fund-raising must be audited by an independent auditor.

*(b) Volunteer risk*

Understaffed NGOs are particularly vulnerable to this type of risk. They tend to accept volunteers without properly vetting their backgrounds, i.e. based on the “warm body” theory – taking any warm body and putting them to work on projects and programs (Matan and Hartnett, 2011). Without proper monitoring and supervision, it might be too late for an NGO to realize that volunteers are taking advantage of their position to channel funds to dummy accounts set up under their names or smaller charities linked to terrorist organizations. Vetting and continuous monitoring are preventive measures not to be taken lightly. Training should also be provided to all, including the Board of Directors. While the board might be suitable for training in governance, strategic planning, money laundering, counter-terrorism awareness, human resources and volunteer management, the volunteers should be sent for training in donor/fund-raising management, ethics in fundraising, basic recordkeeping and financial management. Training programs for volunteers must be made voluntary depending on their role in the NGO.

*(c) Financial risk*

Weak internal controls in fundraising activities and financial management can severely impact on the sustainability of an NGO. Even organizations with adequate internal controls are susceptible to fraud as opportunities and motivations intermingle with the employees and volunteers entrusted with recordkeeping and custody of assets. Internal controls are preventive measures to minimize, if not eliminate, waste or theft. Proper segregation of duties, effective supervision and monitoring, and proper recordkeeping and maintenance are very important to NGOs with limited resources. These very basic internal controls can help facilitate an NGO in achieving its goals or keeping track of its performance. For instance, the segregation of duties can prevent fraud and abuse by making sure that the same person will not perform contradictory functions at the same time, such as processing, validating and authorizing.

As a minimum, the NGO should provide information on how the resources of the organisation were obtained and used during the period, resources available for future use at the end of the period, and reporting on the organisation’s ability to continue to supply services in the future (Razek and Hosch, 1990). The management must also be aware of the fraud indicators such as physical and behavioral indicators (Zack, 2003, p. 280). Physical indicators are the signs of fraud that may surface as a result of the audit of documents, assets, and other physical evidence. Behavioral indicators relate to the changes or unusual patterns of the employee or volunteers, such as refusal to take vacations, always staying late in the office, etc.

*(d) Staffing risk*

Most NGOs do not have proper policies on hiring and firing. They do not have the luxury of choosing from potential candidates applying for jobs as they cannot afford to offer the most lucrative remuneration packages. In fact, the employees are expected to do more with less. It is important to discuss and agree on the job descriptions before a formal recruitment can be finalized. This is to avoid disgruntled employees leaving NGOs in times of need. Employee screening procedures should be a main priority to ensure that the right people are hired so that any form of fraud and abuse can be prevented before it occurs. This involves background checking that goes beyond education and previous employment, such as credit reports, gaps in resume, and references validation (Minogue, 2007).

NGOs must establish, communicate and monitor their code of conduct to national regulator on regular intervals. Commitment to ethical behavior must be clearly communicated to the management, employees, volunteers and related third parties. This must be reinforced throughout training at the time of hiring and later, at refresher training (Minogue, 2007). Any policies must be documented, distributed to employees and reviewed periodically. Any violations of the code should be subjected to disciplinary action to reflect top management's commitment in combating fraud. Top management itself must follow all rules and set good examples.

*(e) Restricted grant risk*

Restricted grant risk is the risk that the NGO cannot fulfill and meet the expectation from the funder of a grant. An NGO tends to "over" promise when it solicits a grant (Matan and Hartnett, 2011). A full understanding of what is expected is important before an application is submitted to any funder. Assessment of prospective funders must also be undertaken to check their background is in line with the NGO's mission and vision. Once a grant is obtained, a proper accounting system must be used to carefully monitor all expenditures to ensure spending does not exceed the grant. Accountability through the establishment of a proper accounting system can increase confidence and trust in the NGO, and this could provide support for funding in the future with the same or other funders. High quality information on the sources and uses of the donations, the cost of the services delivered, and the social benefits of the activity carried out can alleviate the transparency concerns of the society, sponsors, and government (Torres and Pina, 2003).

*(f) Reputation risk*

Reputation risk could bring the downfall of a noble charity due to incidents which are not entirely its fault. Reputation is the greatest "asset" to NGOs' and their constituents. Confidence and trust can be their lifeline in getting support, funding and volunteers. Preventing and protecting reputation should be their main aim. An NGO must make sure it is not linked to any money laundering and terrorism activities. Once tarnished, reputation can take forever to rebuild.

Employees and volunteers portray an NGO's image and reputation, so it is very important that they know the consequences of their actions. NGOs must constantly communicate with their constituents and request their feedback. Any concern should be investigated. Early investigation in any fraud case must be conducted and it is important that corrective actions are taken to prevent it from recurring. The documents or evidence must be preserved to assist the investigation, legal counsel must be contacted and the

investigation must be properly planned and conducted. Immediate and stern actions must be taken, such as dismissing the employee suspected of wrongdoings.

In terms of its operation, an NGO must have proper audit and monitoring procedures in place. Frequent audits by independent auditors must be conducted with special focus on suspected fraud areas such as cash receipts. Though external audit has its inherent limitations, it can be a good signal that the detection mechanism is available. On the other hand, internal auditing can also be a useful tool for detecting fraud when carried out on a continuous basis. The internal auditor must vigorously monitor the internal control system to check it is adequate and working appropriately.

An NGO must establish and disclose their use of the whistleblower programs. Such programs would bring forth suspected fraud or wrongdoings. Zack (2003, p. 262) proposes that in developing and maintaining proper channels of communication managers should provide a method of reporting suspected fraud and abuse in an anonymous manner. All employees should be made aware of the contact details such as an e-mail address or telephone hotline.

### 5. Conclusion and recommendations

This paper examines the US hegemony and primacy over counter-terrorism activities targeting Islamic NGOs worldwide. We propose solutions for improving internal controls and transparency to alleviate concerns of international community over alleged linked with terrorist groups. Muslim international humanitarian relief agencies and charities have been adversely affected through the discriminatory and disproportionate application of freezing orders, police raids, media attacks, and regulatory investigations, in particular in the USA and the UK. We argue that, under the current circumstances, it is crucial that Islamic NGOs get "their houses in order" and implement the best practices to mitigate their risk of being tricked by terrorist groups. These organizations should acknowledge that there are indeed deficiencies and problem areas such as financial transparency and accountability. While freezing the assets of a suspected terrorist-affiliated NGO could disrupt the financial network of the group, it could also mean a lost opportunity for humanitarian operations. We argue that the threat of criminal sections has impeded transparent discussions between these NGOs and governments, due to the risk of criminalization and potential prosecution of staff; many conscientious individuals and NGOs are reluctant even to discuss this issue, let alone to discuss potential solutions for information sharing. International NGOs are increasingly moving toward implementing their own relief and development programs in order to avoid the legal hurdles of partnering with USAID.

On the other hand, governments should be aware that targeting NGOs affiliated with terrorist groups can have negative strategic consequences if they do not introduce better and efficient state-based social services that undermine those provided by the terrorists. Governments must be able to provide high quality and accessible services to the population so that they are not obliged to accept aid coming from terrorist-affiliated organizations. It is only by these actions occurring in tandem that the governments in the developing countries can eliminate the threat posed by non-state groups who are using social welfare provision to advance their own nefarious aims. It is also important that governments should have political will and assume a leadership role in developing policies, procedures, and regulations to govern NGOs and prevent them from being utilized as fronts for terrorism.

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