

LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA
MALAYSIAN ACCOUNTING STANDARDS BOARD

Technical Release *i* -1

Accounting for Zakat on Business

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Accounting for Zakat on Business

Preamble to the Technical Release

Zakat is one of the fundamental obligations in Islam. Its principal objectives are to develop balanced socio economic growth and to purify one's soul and wealth. A type of zakat is zakat on business.

The Board recognises that there is a need to issue an accounting pronouncement for zakat on business for the following reasons:

- (a) there is a lack of guidance on the recognition, measurement and presentation and disclosure of zakat by entities that pay zakat, and an accounting pronouncement would improve the comparability of reported financial information on zakat;
- (b) the issuance of an accounting pronouncement is welcomed by zakat authorities in Malaysia; and
- (c) recently approved tax incentives for zakat on business may lead to more entities to pay zakat. Thus, an accounting pronouncement for zakat on business would be timely.

Arising from this, a working group on zakat was formed. The working group is chaired by a former member of the MASB, and comprises representatives from the accountancy profession, academia, the corporate sector, zakat authorities, statutory bodies and other user groups. Based on the research of the working group, this Technical Release was prepared.

The Board has decided to issue the pronouncement in the form of a Technical Release to provide guidance on the accounting treatment for zakat on business.

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MASB Technical Release *i-1 Accounting for Zakat on Business* (TR *i-1*) is set out in paragraphs 1-19 and Appendix A. All paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are in *italics* the first time they appear in TR *i-1*. TR *i-1* should be read in the context of its objective and the Basis for Conclusions, the *Foreword to MASB Standards and Other Technical Pronouncements*, and the *Proposed Framework for the Preparation and Presentation of Financial Statements*. MASB 1 *Presentation of Financial Statements* and FRS 108 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

It should be noted that TR *i-1* deals only with financial reporting issues related to zakat on business. An entity shall refer to the relevant State Islamic Religious Council or its relevant zakat authorities for any issues relating to zakat on business, e.g. zakat chargeability of an entity, calculation of zakat, determination of zakat base, and zakat eligibility of assets and liabilities. Decisions made by an entity should be subject to conclusion reached with the relevant zakat authorities.

Introduction

Reasons for issuing the Technical Release

- IN1 This Technical Release is issued to provide guidance on the application of generally accepted accounting principles to the recognition, measurement, presentation and disclosure for zakat on business.
- IN2 As at the date of issuance of this Technical Release, there is no accounting pronouncement issued by the International Accounting Standard Board (IASB) on this matter. There is, however, a standard issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) entitled Financial Accounting Standard 9, (FAS 9) *Zakah*. This standard is used as one of the bases of this Technical Release, and examined in light of the Malaysian regulatory and legal framework (see BC6).
- IN3 The purpose of this Technical Release is to standardise the recognition, measurement, presentation and disclosure of zakat on business. Feedback from zakat authorities - either the State Islamic Religious Council or the Zakat Collection Centre of the respective states - and the Malaysian Islamic Development Department (*Jabatan Kemajuan Islam Malaysia*, or JAKIM) have been considered in the development of this Technical Release.
- IN4 The Board recognises that there is a need to issue a pronouncement for zakat on business as there is

disparity in the treatment of zakat among entities that pay zakat. Moreover, the 14 zakat authorities have indicated that they would welcome a uniform accounting pronouncement for zakat on business as it would help reduce the diversity of accounting and reporting practices among the states.

Main features of the Technical Release

- IN5 This Technical Release provides guidance on accounting treatment for entities that pay zakat (see paragraphs 1-2).
- IN6 The Technical Release mentions two common methods used to calculate zakat on business in Malaysia. Both methods would result in the same amount of zakat base (see paragraphs 10-13).
- IN7 Assets and liabilities used in the calculation of zakat on business are based on items and amounts extracted from financial statements prepared in accordance with MASB approved accounting standards (see paragraph 14).
- IN8 The Technical Release requires recognition of zakat as an expense (see paragraph 4).

Objective

- 1 The objective of this Technical Release is to prescribe the accounting treatment and presentation for *zakat on business* in the financial statements of entities that pay zakat. It sets out the overall considerations as well as requirements pertaining to the recognition and assessment of *zakat*, determination of *zakat base* used in the zakat assessment, presentation, measurement and disclosure of zakat information in the financial statements.

Scope

- 2 This Technical Release shall be applied in accounting for, and presentation of, zakat on business in the financial statements of entities that pay zakat.

Recognition

- 3 Zakat for the current period shall be recognised when:
 - (a) an entity has a current zakat obligation as a result of a zakat assessment; and
 - (b) an outflow of resources embodying economic benefits will be required to satisfy the zakat obligation.
- 4 The amount of zakat assessed shall be recognised as an expense in the period in which it is incurred.

- 5 When an entity pays zakat on its business assets, such amount of zakat is recognised as an expense and included in the income statement for the period in which it is incurred.

Assessment of Zakat

- 6 Zakat shall be assessed when the entity has been in operation for at least 12 months, i.e for the period known as haul. Zakat on business shall be calculated by multiplying zakat rate with zakat base.

Zakat rate

- 7 The rate of zakat on business, as determined by National Fatwa Council, is 2.5% of zakat base.

Zakat base

- 8 Zakat base is the net adjusted amount of zakat assets and liabilities used for or derived from business activities. An entity is advised to refer to the relevant zakat authorities for further guidance in determining the net adjusted amount of zakat assets and liabilities.
- 9 For the purpose of this Technical Release, the term "zakat assets and liabilities" refers to assets and liabilities that carry the same meaning as defined in MASB's A Proposed Framework for the Preparation and Presentation of Financial Statements.

Determination of Zakat base

- 10 In determining zakatbase, an entity may apply one of the following methods as recommended by the Malaysian Islamic Development Department (JAKIM) in *Panduan Zakat di Malaysia, 2001*:
- (a) Adjusted Working Capital method; or
 - (b) Adjusted Growth method.
- 11 The adjusted working capital method calculates zakat base as net current assets, adjusted for items that do not meet the conditions for zakat assets and liabilities.
- 12 The adjusted growth method calculates zakat base as owners' equity and long-term liabilities, deducted for property, plant and equipment and non-current assets, and adjusted for items that do not meet the conditions for zakat assets and liabilities as determined by the relevant zakat authorities.
- 13 The method used for the determination of zakat base shall be applied consistently from one period to another.

Measurement of Assets and Liabilities for Zakat

- 14 On the date zakat is assessed, an entity shall measure zakat assets and liabilities on the same measurement basis as used in the preparation of its financial statements.

Presentation

- 15 The amount of zakat assessed for the current period shall be presented as a line item on the face of the income statement.

Disclosure

- 16 An entity shall disclose in the notes accompanying the financial statements the following:
- (a) method used in the determination of zakat base;
 - (b) its responsibility towards payment of zakat on business; and
 - (c) major components of zakat.
- 17 Components of zakat may include:
- (a) current zakat expense;
 - (b) zakat payment;
 - (c) zakat liability; and
 - (d) any adjustments recognised in the period for zakat of prior periods.

Transitional provisions

- 18 This Technical Release shall be applied on a prospective basis only.

Effective date

- 19 An entity shall apply this Technical Release for annual periods beginning on or after 1 July 2006. Earlier application is encouraged. If an entity applies this Technical Release for a period beginning before 1 July 2006, it shall disclose that fact.

Appendix A

Explanations of terms used

The following explanations are intended to serve as a guidepost and may not capture the complexities of the terms. The translations are merely literal renditions that may not necessarily convey the nuances behind the Arabic terms.

haul	a period of twelve operating months. Zakat on business is assessed when the business has been in operation for at least 12 months.
Shariah	Islamic laws derived from the Al-Quran and As-Sunnah .
As-Sunnah	the acts or sayings of Prophet Muhammad (peace be upon him).
zakat	obligatory contribution assessed based on certain assets owned by a Muslim that satisfy certain conditions and is to be distributed to specified categories of beneficiaries.
zakat base	the net adjusted amount of assets and liabilities used for or derived from business activities that are subject to zakat .
zakat on business	obligatory contribution assessed based on business assets owned by an entity that satisfy certain conditions and is to be distributed to specified categories of beneficiaries.
zakat rate	percentage applied to the zakat base to calculate zakat .

Basis for Conclusions

- BC1 This Basis for Conclusions summarises the Malaysian Accounting Standards Board's considerations in reaching the conclusions in TR i-1 *Accounting for Zakat on Business*.
- BC2 The Board recognised that there is a need to issue an accounting pronouncement on zakat as:
- (a) there is a lack of guidance on the recognition, measurement and presentation and disclosure of zakat by entities that pay zakat, and an accounting pronouncement would improve the comparability of reported financial information on zakat;
 - (b) the issuance of an accounting pronouncement is welcomed by zakat authorities in Malaysia; and
 - (c) recently approved tax incentives for zakat on business may lead more entities to pay zakat. Thus, an accounting pronouncement on zakat on business would be timely.
- BC3 In 2002, a working group on zakat was formed with the responsibility for identifying the need for an accounting pronouncement on zakat, and ensuring that the proposed standard is consistent with the requirements of current law and regulations. The working group is chaired by a former member of the MASB, and comprises

representatives from the accountancy profession, academics, the corporate sector, statutory bodies and other user groups. In developing the standard, the Board sought the views of practitioners, accountants, auditors, zakat authorities, regulators, Islamic bankers and users of financial statements.

BC4 As part of the project, a survey was conducted by mail questionnaires to the 14 zakat authorities with the objectives to:

- (a) understand the methods used by the zakat authorities in determining zakat base; and
- (b) seek opinions from the zakat authorities relating to harmonisation of methods used in determining zakat payable.

BC5 All the 14 zakat authorities responded to the survey and indicated that they would welcome a uniform accounting pronouncement on zakat for business to streamline the accounting treatment of zakat.

BC6 The Board also considered AAOIFI's Financial Accounting Standard 9 (FAS 9), *Zakah*. However, AAOIFI's FAS 9 is inappropriate in the Malaysian context because:

- (a) the accounting treatment prescribed are specific for application by Islamic financial institutions that also act as collectors and distributors of zakat; and

- (b) the accounting treatments prescribed might run contrary to state or federal legislation in Malaysia.

BC7 The Board decided to issue the pronouncement in the form of a Technical Release to provide guidance on the accounting treatment for zakat on business.

Scope

BC8 TR *i-1* deals only with entities that pay zakat in their capacity as separate entities that carry out business.

Recognition

BC9 When an entity pays zakat on business, the amount of zakat assessed is recognised as an expense and included as a deduction from net income in the income statement of the entity. This treatment is appropriate as it reflects the discharge of a financial obligation of the entity.

BC10 In addition, the treatment also complies with the definition of expenses in MASB's A Proposed Framework for the Preparation and Presentation of Financial Statements which is defined as decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

Assessment of Zakat

Zakat rate

- BC11 The survey responses indicated that zakat authorities use zakat rate of 2.5% in determining zakat on business. The same rate was prescribed in a resolution by the National Fatwa Council (*Majlis Fatwa Kebangsaan*) dated 9 December 1992. Notwithstanding that, the Board recognises that the state has jurisdiction on matters pertaining to Shariah, and decided that issues regarding the zakat rate on business shall be referred to and determined by the relevant zakat authorities.

Determination of Zakat base

- BC12 This Technical Release mentions two methods of determining zakat base recommended by the Malaysian Islamic Development Department (JAKIM) in *Panduan Zakat di Malaysia, 2001*:
- (a) Adjusted Working Capital method; or
 - (b) Adjusted Growth method.

Both methods would result in the same amount of zakat base.

- BC13 Although the Board propagates these two methods, an entity is advised to refer to its relevant zakat authorities on the method of determining zakat base applicable in its jurisdiction.

Measurement of Assets and Liabilities for Zakat

- BC14 Paragraph 14 of TR *i*-1 states that an entity shall measure assets and liabilities on the same measurement bases used in the preparation of its financial statements. In other words, preparers may use the amounts as reported in the balance sheet since assets and liabilities used in the calculation of zakat are to be measured in accordance with MASB approved accounting standards.
- BC15 The Board decides to adopt this view on the basis that it would ease zakat payers in performing their obligation, facilitate zakat collectors and distributors as well as preserve the rights of zakat beneficiaries.

Issues outside the purview of the Board

- BC16 During the Board's deliberations, several issues related to zakat on business were encountered, e.g. zakat chargeability of an entity, calculation of zakat, determination of zakat base, and zakat eligibility of assets and liabilities. The Board noted that these were important issues, however the Board was of the opinion that such issues fall under the jurisdiction of zakat authorities and were outside the purview of the Board. Thus, the Board decided that TR *i* -1 shall deal only with financial reporting issues related to zakat on business.