Accounting Treatments for Zakat of Companies: A Critical Review

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Abstract

This paper is trying to review the accounting treatment for zakat. Few articles and books have been written on this topic (e.g. Al-Moghaiwli 2001; Mursyidi, 2003, Sulaiman, 2003, Abdul Rahman, 2007 to mention but few). Further, several accounting standards and guidelines have been promulgated and developed on this issue, including the Financial Accounting Standard (FAS) No. 9 by the Accounting and Auditing Organization for Financial Islamic Institutions (AAOIFI), the Technical Release i-1 (TR i-1) on “Accounting for Zakat on Business” and the Financial Reporting Standard (FRS i-1) by the Malaysian Accounting Standard Board.

This paper attempts to first, review those articles and accounting standards. Next, a theoretical examination from both religious as well as from accounting theory perspectives would be done. Some analysis on the practices of Islamic banks and financial institutions will be also carried out to ensure their compliance with both standards promulgated and ontological aspects of zakat.

It is expected that the paper may offer and contribute an alternative view to enrich and improve the accounting treatment for zakat. In turn, it is hoped that this will positively contribute towards a better collection and disbursement of the zakat system, for Islamic commercial institutions in particular as well as for other business organizations in general.

Keywords: Zakat, Accounting Treatment, Accounting Standard, Islamic Institutions.
**Introduction**

The discourse on *zakat* generally, and *zakat* accounting in academic environment particularly has been steadily extending from time to time. It is no longer perceived by many that *zakat* is merely limited as a domain of religious or *sharia* studies and discourses, but has been widening to the issue of social economic matters.

It is commonly understood that first, *zakat* is the third and the very important pillar in **Islamic building**, as it is also mentioned repeatedly in the Holy Qur’an and some *ahadith* (a plural of *hadith’*). Al-Qardawi [2004, 39] notes that some Muslim scholars claim that the Qur’an mentions *zakat* in 82 places. While according to himself, there are 30 times of *zakat* words stated, while 27 of them are affirmed together with the order of *salat* or regular prayers. **This is an evidence of how *zakat* is so imperative in Islamic teaching and Muslim life.**

Second, it is commonly considered as the important alternative in solving the prevalent and most discussed issue in the world, that is a poverty problem. In some Islamic countries, like Malaysia and Indonesia (*insert the data from Malaysian Zakat Institution and BAZNAS*) the **effort to collect *zakat*** has been showing a **remarkable and promising future from year to year**. The collection of *zakat* is also no longer constrained by individual muzakkies (*zakat* payers) only, it has broadened to the institutional payers like companies or corporations.

The importance of *zakat* cannot be detached from accounting, either for individual *zakat* payers, or institutional or business sector. What is stated in QS 2:282 is just one of evidences about the imperative of accounting in human life, which include in the *zakat* practices. The issue of *zakat* and accounting has attracted the academia to take into account. Some limited papers and books have been published. The following are just to mention but few: Al-Moghaiwli [2001], Al-Habshi [2003, 2004], Maliah [2003, 2005],

1 *hadith* (*hādēth’*), a tradition or the collection of the traditions of *Muhammad*, the Prophet of Islam, including his sayings and deeds, and his tacit approval of what was said or done in his presence. [http://www.answers.com/topic/hadith ]
Among those publications, albeit they were pertaining to *zakat* and accounting, perhaps only one or two of them discuss specifically the accounting treatments of *zakat* for business organization. In other words, many papers just discuss general ideas and not yet develop the steps into development of accounting standard that need to be conformed by *zakat* payers of organizational sector.²

It is fortunate when this issue has been taken into account by some accounting regulation bodies, like the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the Malaysian Accounting Standard Board (MASB) and the Indonesian Institute of Accountant (Ikatan Akuntan Indonesia – IAI).

Looking at the need of many corporations which have started to pay attention in payment of *zakat*, the three above mentioned institutions, for example, have also promulgated the standard which governs the accounting treatment for *zakat* that is paid by the companies or corporations.

The issuance of accounting standard for *zakat* should have been affecting two things. One is the standardization of accounting treatment for *zakat in every company* which pay *zakat* regularly, so that it can fulfill one of the objectives accounting standard in the senses of uniformity and comparability among the related industry or at least *zakat* payers, hence in turn, it helps also the auditing process of *zakat* accounts particularly [See also Abdul Rahman, 2007, 92].

The other positive impact of *zakat* accounting standard is perhaps, the expectation of the increase of *zakat* collection, especially from the corporate sectors, as an addition to individual sector. However, there is no such survey or research has been conducted to

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² Since the companies or corporations are committed fully to the principles of transparency, they can not avoid the obligation to make a report of the *zakat* payment, as this is also related to many other factors like measurement, recognition, and disclosures.
examine the influence of zakat accounting standard to the amount of zakat collected from the companies sector.

This paper is not intended to examine the later mentioned issue above, but rather to study the accounting treatments that have been governed by the standards issued by the existing accounting standard bodies, such as AAOIFI, MASB and IIA. The rationale behind this study is that the concern about the existing standards which are believed to have not yet set up the accurate and more correct treatments of zakat. Since it is commonly believed that accounting is strongly related to behavior [See for example Choi and Levich, 1990 in, and Godfrey et al, 2006], it can also be analogized that incorrect accounting treatments for zakat, would also affect the practices of zakat, particularly in the companies environment. What was found by Al-Moghaiwli [2001] in the case of Saudi Arabia, perhaps the clear evidence of this concern. His research found that managers of Saudi companies manage earnings via the accounting for zakat so as to maximize their own wealth and/or the market value of their companies.

Among the example of incorrect accounting treatment for zakat is that the understanding and classification of zakat paid. All existing accounting standards, as well as commonly understood and practiced by most, if not all parties, the zakat is easily understood and hence classified as one of ‘expense accounts’ [See also: Abdul Rahman, 2007]. Given this, the amount of the assets provided or paid for zakat has been also simply classified and treated as “expense” generally. Is this true? There is no such conceptual examination has been conducted, unfortunately.

This is the aim of this study in nature. The authors were very much concerned with this fundamental issue. This paper is therefore seeking for scrutinizing the accounting treatments as promulgated by different accounting standard bodies from the conceptual framework point of view.

The paper is organized as follows. After the introduction, the review on accounting treatments is presented. All accounting treatments promulgated by AAOIFI, MASB and
IIA are briefly described. Afterwards, the examination based on the conceptual framework is conducted. The view of above discussion is then offered in the following section.

A Review of Accounting Treatments
To date, there are several accounting regulation bodies which are very much concerned with the issue of accounting treatment of zakat paid by companies. These include the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the Malaysia Accounting Standard Board (MASB) and the Indonesian Institute of Accountant (IIA or Ikatan Akuntan Indonesia - IAI).

The AAOIFI has issued the Financial Accounting Standard (FAS) No. 9 which specifically govern the accounting treatments for zakat of Islamic banking and Islamic Financial Institutions. The standard was adopted by the board on its meeting held on 21 – 22 June 1998, and were effectively applied into practice from 1 Muharram 1420 H or 1 January 1999 [para 21].

In the case of Malaysia, it has released the MASB Technical Release i –1: “Accounting for Zakat on Business” and obliged the related parties to apply it for annual periods beginning on or after 1 July 2006. While in Indonesia, according to Sriyanto, Technical Director of Indonesian Institute of Accountants [See: http://www.kafeis.or.id/?pilih=lihat&id=439], the standards would be expected to issue on March 2008. However, unlike the AAOIFI’s FAS No. 9 and MASB’s Accounting for Zakat on Business, the Indonesian accounting standard is mainly designed to accommodate the Zakat Institutions which are spread numerously in the country, either in the forms of public (organized by the government) or private entities. The major reason of designing the accounting standard for zakat for the purpose of zakat institutions is the assumption given by the Indonesian Ulama Council, that muzakkies are individuals, and not companies, as quoted by Sriyanto [Aru, Republika, 2007]. The companies or business entities, accordingly are not obliged to pay zakat. Although the Islamic banks are allowed to
collect the zakat (from their customers and employees, for instance), as well as to distribute it appropriately.

Because of above condition, the review of existing accounting treatments for zakat as promulgated by the authorized bodies, are focused merely on the AAOIFI’s FAS 9 and the MASB Technical Release i –1.

The accounting standards generally used to deal with some basic issues, which include the definition and or classification, recognition, measurement, presentation and disclosures. This review will be directed toward these issues.

First, the definition, account classification and recognition. According to the AAOIFI:

“zakat means “blessing, purification, increase and cultivation of good deeds.” In Shari’a, it is an obligation in respect of funds paid for a specific type of purpose and for specified categories…….The government may also authorize shareholders to pay it personally if it is satisfied that they will do so, or it may instruct Islamic banks to organize its payment on behalf of Islamic banks’ shareholder, using the combined basis for nisab as described [above].” [AAOIFI, 2001, p. 322].

In regards to treatment for zakat, the FAS 9 classifies two scenarios. One is the cases in which the Islamic is obliged to pay zakat. The other is the scenario in the cases in which the Islamic bank is not obliged to pay zakat. There are three conditions should be fulfilled to categorize the Islamic banks into first scenario, that are: (a) when the law requires the Islamic banks to satisfy the zakah obligation; (b) when the Islamic bank is required by its charter or by-laws to satisfy the zakah obligation, and (c) when the general assembly of shareholders has passed a resolution requiring the Islamic bank to satisfy the zakat obligation [AAOIFI-FAS 9, 2001, para 9].

In any above situation, according to FAS 9, “Zakah shall be treated as (non-operating) expense of the Islamic bank and shall be included in the determination of net income in the income statement”. In terms of financial outflow, it seems suitable to treat zakat as an expense. However, substantially it is hard to accept the treatment of
zakat as an expense, particularly when zakat is seen from its basic understanding. The discussion about this will be further continued at later in the following section.

Unlike the AAOIFI which provide two possible scenarios, the MASB Technical Release i –1, has focused the accounting standard only for business. This means that it can be used by any company of existing industry. **The MASB defines zakat as “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.”** While zakat on business is defined as: “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.”

Based on the above understanding, when an entity pays zakat on its business assets, such amount of zakat is recognized as an expense and included in the income statement for the period in which it is incurred.

In regards of definitions, the FAS 9 still provides the more comprehensive and closely related definition to the zakat definition as it is very much understood in the fiqh concept, as compared to the MASB Technical Release i –1. The later, as cited earlier, defines it very technically.

However, the account classification and recognition of zakat is defined almost similarly by both FAS 9 and the MASB Technical Release i –1. **If FAS 9 recognizes it as (non-operating) expense, and has to be included in the determination of net income in the income statement, the MASB Technical Release i –1 recognizes as an expense and included in the income statement for the period in which it is incurred.**

Second: the measurement and zakat determination. FAS 9 offers two different methods. However, each would result exactly the equal value, provided that the items are classified and valued consistently with due considerations given to the different valuation
basis in them [para 8]. The first method is known as the Net Assets Method which offers
the formula as follows:

… zakah base = assets subject to zakah – (liabilities that are due to be paid
during the year ended on the date of the statement of financial position +
equity of unrestricted investment accounts + minority interest + equity
owned by government + equity owned by endowment funds + equity
owned by charities + equity belonging to not-for-profit organizations
excluding those that are owned by individuals) [para 3]

The second method is called as Net Invested Funds method. The formula, or zakat base
shall be calculated as follows:

Paid up capital + reserve + provisions not deducted from assets + retained
earning + net income + liabilities that are not due to be paid during the
year ended on the date of statement of financial position – (net fixed assets
+ investment not acquired for trading, e.g. real estate for rent +
accumulated losses). [para7].

The MASB Technical Release i –1, on the other hand, also recommends two methods: (a)
Adjusted Working Capital method; and (b) Adjusted Growth method. The first method
calculates zakat base as net current assets, adjusted for items that do not meet the
conditions for zakat assets and liabilities. 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. It is
emphasized that a business entity has to apply any chosen method consistently from one
period to another, although both methods would result in the same amount of zakat base.
Unlike the FAS 9, the MASB Technical Release i –1, does not provide the example of
each method which proves the same amount of zakat base.

Third, the presentation. The FAS 9 of AAOIFI set up the presentation of zakat according
two scenario formed: the Islamic bank which is obliged to pay zakat and the Islamic bank
which is not obliged to pay zakah. For the first scenario, as alluded earlier, the zakah shall
be treated as a (non-operating) expense and shall be included in the determination of net
income in the income statement. The unpaid zakah shall be treated as a liability and
presented in the liabilities section in the statement of financial position of the Islamic bank.

In addition to above, the section “2/2/3” of FAS 9, states that “The Zakah due from Islamic bank as well as amounts of zakah received from other sources of funds shall be presented in the statement of sources and uses of funds in the zakah and charity fund [para 12].

In the MASB Technical Release i –1, presentation of zakat is set up in point 15, where it states: “The amount of zakat assessed for the current period shall be presented as a line item on the face of the income statement.”

Fourth, disclosure. In this regard, FAS 9 set up eight rules about disclosure, which include: the obligation to make in notes accompanying the financial statements of: method used for determining the zakah base and the items included in the base [para 13]; the ruling the Sharia’s supervisory board of the Islamic bank on the issues related to Zakah that are not included in the standard [para 14]; whether or not the Islamic bank as a holding company pays its share of Zakah obligations in its subsidiaries [para 15]; the amount of zakah that is due from each share (if the bank does not pay zakah) [para 16]; the amount of Zakah that is due from the equity of investment account holders [para 17]; whether or not the Islamic bank collects and pay zakah on behalf of holders of investment accounts and other accounts [para 18]; the restrictions imposed by the Shari’a supervisory board of the Islamic bank in determining the Zakah base [para 19]. In addition, in the last paragraph [i.e. para 20] of disclosure requirement, it also states the need to observe the FAS No 1: General Presentation and Disclosure in the Financial Statements of Islamic Banks and Financial Institutions.

The disclosure requirements are set up in the points 16 and 17 of MASB Technical Release i –1. The requirements are much more simple than the rules set up the FAS 9. It states, for example, the entity shall disclose in the notes accompanying the financial statements (a) method used in the determination of zakah base; (b) its responsibility towards payment of zakat on business; and (c) major components of zakat. It is stated
Components of zakat may include: (a) current zakat expense; (b) zakat payment; (c) zakat liability; and (d) any adjustments recognized in the period for zakat of prior periods.

**An examination on some concepts**

The examination is addressed to some basic issues which are generally covered in the accounting standard. They include: definition and classification of account, recognition, measurement, presentation and disclosure.

**Definition and account classification**

Although the zakat definition is put as an appendix (D: Juristic rules for zakah, p 322, 2001) in FAS 9, the AAOIFI seems to have use it as a reference to commence the standard. It is basically the ideal step to start with. The given understanding of zakah as quoted earlier is generally accepted from sharia’a. The same definition is almost used by any standard zakat textbook or other sources [E.g. Qardawi, 2004; Muhammad, 1980 and Sabiq, 1985 in Abdul Rahman, 2007]. However, the zakat definition has been plainly interpreted by FAS 9 in the accounting term as the “expense”.

In our opinion, the plain interpretation of zakat paid into ‘expense’ cannot be simply accepted without scrutinizing it seriously against the substance meaning of zakat.

The following view need to be understood as initial steps in understanding the substance of zakat. First, the ownership concept of Islamic perspective. It is very clear in the view of Islam that the real owner of every thing in this world is Allah alone. [See for example: QS 2:115,116, 191, 284; 42: 4, 12, 49, 53; 43:83; 45:27; 48: 7, 14 to mention but few]. Due to this, it is comprehensible if Adnan [1997], Triyuwono [1997] and Hameed [2000] proposed that the ultimate goal of financial accounting should be directed to the Real Owner. However, since He is the All-Knower and Al Khabir (Well-Acquainted), He does not need such report or information. Due to this, the purpose of financial accounting should be directed to fulfill His command, that is to pay zakat for those who have fulfilled the requirements set up. In this regards, the financial statements should be prepared to
facilitate the stakeholders (shareholders and employees, particularly) of the company to calculate their zakat.

The meaning of zakat has been cited earlier, that is a “blessing, purification, increase and cultivation of good deeds.” This means that, who has performed the zakat obligation would be blessed, purified and increased his or her wealth. The payment of zakat is the prove that particular Muslim (1) obeys fully the command of Allah, and (2) grateful Allah on the unlimited bounties He has been giving continuously. At the other side, for those who has devoted him or herself to Allah in obeying His command, Allah also has promised the reward. Among others, In the Qur’an Chapter 2:261, Allah has also described the multiplier of wealth paid on His way (which include zakat) to be seven hundred times. This means that, the asset paid in the form of zakat might be growing significantly.

The other reason behind the command to pay zakat is because in someone’s wealth there is a wealth of the poor and needy people that should be transferred to them accordingly [QS 17:26].

In very well acknowledged hadith narrated by Bukhari and Muslim, Rasulullah (pbuh) reminded that all reward of any human-being will be cut-off in directly after his / her death, except for three things, namely: shadaqah jariah (which include zakat), the knowledge shared and well utilized by others and the saleh off-springs who make the do’a (call) for his / her parents. This hadith confirms the different of zakat compared to any other payment done by someone. It is basically the real [if not eternal] asset belonged to who has paid it sincerely.

Due to above offered arguments, it is not acceptable to assume zakat payment to be simply look like any other obligation payment, or expense. The inappropriateness of

3 “The likeliness of those who spend their wealth in the Way of Allah is as the likeness of a grain (of corn); it grows seven ears, and each ear has a hundred grains. Allah gives manifold increase to whom He wills. And Allah is All-Sufficient for His creatures’ needs, All-Knower. [QS 2:261].
assuming zakat as an expense can be further analyzed using the understanding of expense from general accounting understanding.

There are many definitions of expense, as it also develops from time to time. Perhaps the most simple definition can be seen from http://www.investorwords.com/1842/expense.html, where expense is defined as “any cost of doing business resulting from revenue-generating activities”. It is obvious that zakat cannot be classified as an expense since it is not resulting [merely] from revenue-generating activities.

The second definition of expense may be referred to free financial dictionary. [See: http://financial-dictionary.thefreedictionary.com/Expenses]. It defines expense as:

1. Money spent by a firm to continue its ongoing operations. (2). Money spent or costs incurred that are deductible and reduce your taxable income. Notes: Expenses are the opposite of income. Costs that are not deductible are called "capital expenditures" and they must be depreciated or amortized instead.

Again, it is hard to simply classify the zakat obligation as an expense, if the above understanding of expense is adopted. The Zakat is neither intended to continue the ongoing operations of the business, nor for purpose of capital expenditure. It is also not the payment that will be deducted only from the income, because zakat determination is also based on the assets. It means that, in certain condition, although the company has not resulted the income, as long as the total net assets value achieve the nisab, the obligation to pay zakat cannot be avoided.

More definitions of expense (as they are also developing from time to time) can be referred as follows:

Expense: The decrease in net assets as a result of the use of economics service in the creation of revenues or the imposition of taxes by government units (The AICPA ARS No.3)

Expense in the broadest sense include all expired costs which are deductible from revenues [Committee on Terminology, Accounting Terminology
Expenses – gross decrease in asset or gross increase in liabilities recognized and measured in conformity with generally accepted accounting principles that result from those types of profit directed activities of an enterprise [Accounting Principles Board, Statement No. 4, para 134.]

Expense are outflows of other using up of assets or incurrences of liabilities (or a combination of both) during a period from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity’s major or central operations [FASB, SFAC No. 6; para 80].

Expense are decreases in economic benefit during the accounting period in the form of outflows or depletion of assets or incurrences of liabilities that result in decrease in equity other than those relating to distributions to equity participants. [Framework, para 70 in Godfrey et al, 2006]

A further and in-depth examination on each above definition of expense, none of them seems to be suitable with the substance meaning of zakat. Except that the zakat is decreasing the asset or increasing the liability, or combination of both. However, the purpose of cash outflow in zakat payment cannot be equalized with any type of expense definition. Because of this reason, it is very arguable to simply classify the zakat payment as an expense.

All above definitions of expense are referred to conventional or Western accounting thought. The examination of classifying zakat account can also be scrutinized from the Conceptual framework promulgated by Islamic accounting authority like AAOIFI and MASB. Although the later can not be simply considered as a full Islamic authorities, due to its process which did not include the Muslim shari’a scholars. (????).

Expense are gross decrease in assets or increase in liabilities or a combination of both during the period covered by the income statements which result from legitimate investment, management of investment, trading and other activities of the Islamic bank, including the rendering services. (SFA No. 2; para 33).
Unlike the definitions cited from the conventional Western sources above, the AAOIFI adds to the expense definition, the following characteristics:

a) The gross decrease in assets or the gross increase in liabilities should not be the result of distribution to or investment by owner(s), withdrawals or deposit by unrestricted investment account holders or their equivalent, or withdrawals or deposits by current or other non-investment account holders.

b) The gross decreases in assets or the gross increases in liabilities should have the same characteristics of assets and liabilities.

c) The gross decreases in assets or the gross increases in liabilities should relate to the period covered by the income statement.

Referring to and further interpreting Adnan’s [1997], Triyuwono’s [2000] and Hameed’s [2003] view that Allah Almighty the Real Owner, as this is also very frequently pointed out the Holy Qur’an [See for example: QS 2:115,116, 191, 284; 42: 4, 12, 49, 53; 43:83; 45:27; 48: 7, 14 to mention some of them], the payment of zakat is substantially the manifestation of payment to Real Shareholder. Given this, the first criteria stated above can not be fully matched. In other words, the classification of zakat to be simply as an expense (operating or not) is not acceptable. The existing classification which found both in FAS 9 and MASB Technical Release i-1 should be consequently refused. The question now is: how to treat the zakat more appropriately?

Our argument above has indirectly answered the question. The payment of zakat is neither non-operating expense, nor any other type of expense. Since it is payment with a special purpose, that is to fulfill one of obligations to the Real Owner, it is then closer to the thing that used to paid to “temporary owner”, i.e. shareholders. Such payment is so far known as a dividend. Consequently, the zakat payment shall also be treated as a treatment of dividend. This treatment is much more relevant than to treat it as an expense.

Recognition.

The recognition in accounting refers to the determination of time to record a transaction [See: SFA No. 2, para 81]. The FAS No 9 does not specifically set up the recognition.
issue in regard to zakat. However, as it is attached in its Appendix D, the concept of nisab\(^4\) and hawl\(^5\) are fully acknowledged, then it is commonly agreed that the recognition concept has to be related to the nisab and hawl. This means that, the recognition is subject to the fulfillment of nisab and hawl requirements. We do not see any problem on this regard from both FAS 9 and MASB Technical Release I – 1.

**Measurement**

In regard to measurement, The SFA No. 2 states that:

“accounting measurement refers to the determination of the amount at which assets, liabilities and , in turn, equity of the holders of unrestricted investment accounts and their equivalent and owners’ equity are recognized in the bank’s statement of financial position.” [para 82].

It is generally understood that measurement in relation with zakat is about the determination of amount of zakat liable to the zakat payer. It has been reviewed above that both FAS No. 9 and MASB Technical Release i-1 offer two different method. Both accounting bodies have also stated that each of method would result the same zakat base, as long as the accounts involved are consistently treated periodically. The difference appear among the methods proposed is that the FAS 9 is prepared only for Islamic banks and financial institutions only, while the MASB Technical Release i-1 can be used for any business organization.

The essence of calculation methods offered by each accounting body seems to be also comparable, although the names of method offered are different. However, we also see some problematic issue, when measurement is integrated with the expense concept, as discussed above. Let us take the Net Invested Fund method as proposed by FAS 9, or the Adjusted Growth method as set up by the MASB Technical Release i-1. The zakat base in each method is determined based on (among others) the value of equity account, where among others it consist of Net Income for the year. This means that the income statement should have been prepared initially, since it is impossible to have balance sheet prior to

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4 “Nisab is the minimum amount not liable to the payment of zakat” [See: AAOIFI, 2001, p. 323]
5 “…is the passing of a lunar calendar year, starting on the day on which the nisab is attained” [See: AAOIFI, 2001, p. 323].
the preparation or calculation of net income. It is totally not clear, whether in the
calculation of net income the “zakat expense” has been accommodated. There are two
possible answers. One is that Zakat has been ‘expensed, so that Zakat has reduced the
value of net income. The question is: on what kind of base that Zakat was counted in the
income statement ‘expense’ account?

The other possibility is that, the Zakat was not yet included in the net income calculation.
This means that the net income of the year still ‘covers’ ‘the “Zakat expense”. Then, this
value will be used in the base of Zakat calculation. This situation seems to have neglected
the standards (both FAS 9 and MASB TR i-1), since they clearly stated that the Zakat due
is a part of expense that has to be recognized during the calculation of net income. It is
very obvious here, how [Zakat] definition, classification, recognition and measurement
(as set up by both FAS 9 and MASB TR i-1) is conflicting each other?

Presentation
In terms of presentation, as Zakat is so far assumed to be a [non – operating] or just an
expense, both FAS 9 and MASB Technical Release i – 1, set up to present it as any other
expense account. This means that the Zakat is supposed to be presented in the Income
Statement. The unpaid Zakat – according to FAS 9 – shall be treated as liability and
presented in the liabilities section in the statement of financial position of the Islamic
bank. In addition to this, FAS 9 has required the Islamic banks to present the statement of
sources and uses of funds in the Zakat and charity fund [para 21].

The above presentation requirement is logical as a consequence of assuming Zakat as
similar to expense. However, since our argument proves that the treatments proposed by
both FAS 9 and MASB Technical Release i-1 is not acceptable, then the presentation
shall also be adjusted.

As we have proven above, that conceptually (both form Islamic and accounting point
view) Zakat cannot be simply understood as expense. It is, however, closer or more
suitable to be considered as a payment to the Real Owner or Shareholder, hence it is
supposed to be treated as the treatment of dividend. The dividend, as generally accepted, is presented in the equity group of accounts. The distribution of dividend is normally treated as a deduction of equity, or more specifically, a deduction of retained earning. This also in line with the concept of measurement where zakat shall be calculated based on either net invested fund (a second method offered by FAS 9), or adjusted growing method as proposed the MASB TR i-1. To present zakat as an expense as set up by both FAS 9 and MASB TR i-1, has no conceptual basis, as already discussed and proven above.

**Disclosure.**

Disclosure is about to provide all material information needed by the users of financial statements [See SFA No. 2, para 130]. As reviewed above, the FAS 9 has stated eight requirements that need to be disclosed accompanying the zakat payments reported by Islamic bank and financial institutions. The MASB TR i-1 on the other hand, requires less complex disclosure.

The examination on the requirements set by two accounting bodies, brings us to the understanding that the those requirements or logical and acceptable. All are conceptually satisfactory and practicable. The main problem with this issue is that the devotion to and or compliance with those requirements as shown by many Islamic banks as well as companies. Some of observed companies in Malaysia particularly, only present zakat as expense, and provide no disclosure at all. Obviously this is the challenge that has to be solved by the related authority bodies in the near future, because the standard has visibly set it up.

**Concluding Remarks**

The paper has tried to review critically the accounting treatments for zakat of business organizations, particularly the two standards or technical release issued by the AAOIFI (i.e. FAS No 9) and the MASB (Technical Release i-1). They were examined both from the substance of zakat understanding and the accounting conceptual framework, which include the definition and classification, recognition, measurement, presentation and
disclosures. Two conceptual discourses were referred respectively: the Western conventional accounting, and Islamic one issued by the AAOIFI.

Two fundamental objections were raised accordingly. One is the definition and the recognition of zakat. In turn, it relates with the presentation. The other is the issue of measurement, or determination of zakat.

Due to above concerns, we believe strongly that the need to rectify the existing standards cannot be avoided. All related parties have to take into account these important issue as they would affect not only the technical matters for zakat accounting, but also the behavioral impact of zakat payers.
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