



Accounting treatment for corporate zakat: a critical review

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Abstract

Purpose – The purpose of this paper is to review the accounting treatments for corporate zakat, as advocated by accounting standards and guidelines, as well as those been practised by relevant corporations. The aim is to determine their appropriateness and adherence to both the Islamic as well as the accounting theoretical perspectives.

Design/methodology/approach – Accounting standards and guidelines related to zakat, including the Financial Accounting Standard No. 9 and the Technical Release *i-1*, are examined. Additionally, analyses are made on the practices of Islamic financial institutions to determine their compliance with both standards and ontological aspects of zakat.

Findings – The study reveals that there is a general misconception of zakat, as indicated in several standards and guidelines, which has consequently resulted in inappropriateness in their proposed corporate zakat recognition and measurement and hence presentations. These inaccuracies, in one way or another, have not been in line with the true spirit of zakat in Islam. More worryingly, some unfavorable consequences may and in fact have already been implicated on the larger Muslim community as a result.

Research limitations/implications – An alternative view on the accounting treatment of corporate zakat is offered in this paper with the aim to provide a fair and proper assessment of zakat on corporate wealth, which is more parallel to the true spirit of zakat.

Originality/value – The paper integrates both the revealed and the contemporary accounting knowledge in scrutinizing the standards and practices as well as in recommending an improved and meaningful alternative.

Keywords Islam, Accounting procedures, Accounting standards, Social economics

Paper type Viewpoint



1. Introduction

The discourse on zakat generally and zakat accounting in the academic environment in particular has been steadily expanding. It is no longer perceived by many that zakat is merely limited to the domain of religious or sharia studies and discourses, but has been widened to include the issue of social economics.

It is commonly understood that zakat is the third pillar of Islam. It is also mentioned repeatedly in the *Holy Quran* and some *ahadith* (a plural of *hadith*[1]). Al-Qardawi (2004, p. 39) notes that some Muslim scholars claim that the *Qur'an* mentions zakat in 82 places, while according to Al-Qardawi himself, the word is stated some 30 times, while 27 occurrences are affirmed together with the order of salat or regular prayers. This is evidence of how important zakat is in Islamic teachings.

Second, zakat is commonly considered as an important alternative to solving one of the most prevalent social and economic problems in the world, namely poverty. In some Muslim countries, like Malaysia and Indonesia for example, the effort to collect zakat has showed a remarkable and promising upturn. The collection of zakat is no longer constrained by individual *muzakkies* (zakat payers). It has rather broadened to institutional payers like companies or corporations.

The fact that zakat is a “financial” form of *ibadah* makes the computation of zakat indispensable in fulfilling this obligation. Accounting, as a medium of computing zakat, thus has a role in determining a proper and fair assessment of payable zakat. The importance of accounting is in fact not only limited to zakat obligation, but also to other aspects of human life. This has been duly recognized in Islam as stated in *Al-Quran* 2:282.

This link between accounting and zakat has stimulated wide-ranging discussion among academics. As mentioned, there are however only limited papers and books published in this area. These include Al-Moghawli (2001), Al-Habshi (2005), Sulaiman (2003), Mursyidi (2003), Khan (2003), Islahi and Obaidullah (2004), Bahari and Hamat (2004), Abdul Rahman (2002, 2007) and Abu Bakar (2007).

Among those publications (albeit pertaining to zakat and accounting) very few focused on the accounting treatments of zakat for business organizations. However, despite the limited literature it is fortunate that there are a number of regulatory bodies in some countries which have actually taken plausible moves by developing accounting standards (or at least accounting guidelines), which may be useful for business zakat assessment. These bodies include the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the Malaysian Accounting Standard Board (MASB) and the Indonesian Institute of Accountant (IIA). Their commendable initiatives towards the promulgation of zakat-related standards are arguably stimulated by the increasing number of business organizations performing this obligation.

This paper however does not intend to examine the above-mentioned issue, but rather to study the accounting treatments that have been proposed by the standards issued by the said accounting bodies (i.e. AAOIFI, MASB, and IIA). The rationale behind this study is based on the premise that the current accounting standard does not offer a fair and proper assessment of zakat wealth for corporations. A case in point is that zakat assets and zakat paid is treated as one of a number of “expenses” in a company’s income statement. This misclassification is simply a manifestation of the respective bodies’ misconceptions about the overall spirit and nature of zakat in Islam.

More fundamentally, the mistreatment primarily stems from the way in which the standard setters view the ownership of business organizations, whereby they presume that a company belongs 100 percent to its shareholders. This is unlike the Islamic concept of wealth ownership whereby Allah is the ultimate Owner of all assets and wealth, and this definitely applies to business entities as well.

As a result of this mistreatment of zakat wealth, it is feared that some negative attitudes and behaviors in performing this obligation might arise among some corporations. The idea of how incorrect accounting treatment may result in unfavorable practice is actually in line with one well-supported accounting theory proposition. This argues that accounting will influence people’s behavior (and their environment) as well as vice versa (Choi and Levich, 1990; Godfrey *et al.*, 2006). This is

supported in Al-Moghaiwli's (2001) study conducted in Saudi Arabia, whereby his research found that managers of Saudi companies managed earnings via accounting for zakat so as to maximize their own wealth and/or the market value of their companies.

In light of the above, it is vital that there should be a proper and fair accounting treatment and assessment of a corporation's zakat, not only to ensure positive and favorable zakat behavior among corporations, but most importantly to ensure that these corporations can rightly fulfill their zakat obligations. It is the aim of this study to explore this issue utilizing a conceptual framework point of view, and by scrutinizing the existing accounting treatments for zakat.

The paper is organized as follows: a review on accounting treatments is first presented, whereby all accounting treatments promulgated by AAOIFI, MASB, and IIA will be briefly described. Afterwards, an examination based on the conceptual framework is conducted. An alternative view of the above discussion is then offered in the final section of this paper.

2. Accounting standards related to corporate zakat assessment

"Accounting standard" refers to accounting guidelines developed to deal with specific financial accounting and reporting issues. To date, there are several accounting regulatory bodies that have demonstrated their concerns regarding the accounting treatment of corporate zakat by issuing accounting standards or guidelines. This includes the AAOIFI, the MASB, and the IIA.

The AAOIFI has issued the Financial Accounting Standard (FAS) No. 9 which specifically governs zakat accounting treatments for Islamic banking and financial institutions. The standard was adopted by the AAOIFI Board at its meeting of June 21-22, 1998, and effectively applied into practice from 1 Muharram 1420 H or January 1, 1999 (para 21).

In the case of Malaysia, it has released the MASB (2006) Technical Release *i-1* (TR *i-1*): "Accounting for Zakat on Business", that became effective on July 1, 2006. TR *i-1*, however, emphasizes that since most business-related zakat issues fall under the SIRC's jurisdiction (and thus are considered outside the MASB's purview), TR *i-1* only deals with financial reporting issues related to a corporation's zakat (Abu Bakar, 2007). Other decisions on a corporation's zakat made by an entity (including issues such as zakat chargeability, calculation, determination of the zakat base, and eligibility of assets and liabilities) should be subject to the conclusions reached in co-operation with the respective zakat center.

In Indonesia, according to Sriyanto, Technical Director of The IIAs (www.kafeis.or.id/?pilih=lihat&id=439), the standards are expected to be issued in March 2008. However, unlike the AAOIFI's FAS No. 9 and MASB's TR *i-1*, the Indonesian accounting standard is mainly designed to accommodate the scores of zakat institutions that exist in that country, either in the form of public (established by the government) or private entities. The main reason for designing the accounting standard for zakat for the purpose of zakat institutions is the assertion put forward by the Ulama Indonesian Council that *muzakkies* are individuals and not companies, as quoted by Sriyanto (Aru, 2007). The companies or business entities accordingly are not obliged to pay zakat. In the case of Islamic banks, however, they are allowed to collect

zakat (from their customers and employees), as well as to distribute zakat appropriately.

Owing to the above conditions, the review to be conducted on the existing accounting treatments for corporate zakat will be focused on the AAOIFI's FAS 9 and the MASB TR *i-1*.

3. Accounting treatments for corporate zakat

The accounting standards are generally used to deal with basic issues including definition, classification, recognition, measurement, presentation and disclosures. This review will be focused on these issues.

This discussion will first commence with 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' shareholders, using the combined basis for *nisab* as described [above] (AAOIFI, 2001c, p. 322).

With regards to the treatment of zakat, the FAS 9 describes two possible scenarios. One is the case in which an Islamic bank is obliged to pay zakat. The other is the opposite of this. There are three situations in which an Islamic bank may fall into the first category: first, when the law requires the Islamic bank to satisfy their zakat obligation; second, when the Islamic bank is required by its charter or by-laws to satisfy their zakat obligation; third, and/or when the general assembly of shareholders has passed a resolution requiring the Islamic bank to satisfy their zakat obligation (AAOIFI, 2001a, FAS 9, para 9).

Unlike the AAOIFI FAS 9, which is basically meant for Islamic financial institutions and thus may not be immediately applicable to other (business) entities (Abdul Rahman, 2002; Abu Bakar, 2007), the MASB TR *i-1*, has focused the accounting standard only for business. This means that it can be used by any company in any 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 an "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."

Examining the definitions offered by both FAS 9 and TR *i-1*, the former definition can be considered as both more comprehensive as well as closer to the true concept of zakat. The latter, as stated earlier, defines zakat very technically.

However, the account classification and recognition of zakat is defined quite similarly by both FAS 9 and the TR *i-1*. FAS 9 recognizes it as a non-operating expense that has to be included in the determination of net income in the income statement. The same goes for the TR *i-1*, which recognizes it as an expense to be included in the income statement for the period in which it is incurred. It is argued here that though the transaction, and thus the consequent treatment may be agreeable to the expense concept in accounting, it does not augur well with the intended spirit of paying zakat. This point will be further elaborated in a later section of this paper.

The second issue is regarding the measurement and zakat determination. FAS 9 offers two different methods. These two approaches however yield the same result, provided that the items included are consistently classified and valued, with due considerations given to the different valuation basis in them (para 8). The first method is known as the Net Assets Method, which is based on the following formula:

[...] zakat base = assets subject to zakah – (liabilities that are due to be paid during the year ending 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 the net invested funds method. In this instance, 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 TR *i*-1, on the other hand also recommended two methods: adjusted working capital method; and 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 TR *i* – 1, does not present any example for each method suggested.

The third issue is regarding the presentation. The FAS 9 of AAOFI characterized the presentation of zakat as depending on two circumstances (i.e. the Islamic bank which is obliged to pay zakat and the opposite situation).

In the first scenario, where an Islamic bank is obliged to pay zakat, as alluded to earlier, the zakat shall be treated as a non-operating expense and shall be included in the determination of net income in the income statement; whereas the unpaid zakat shall be treated as a liability and presented in the liabilities section of the statement of financial position of the Islamic bank. In addition to the above, section 2/2/3 of FAS 9 states:

[...] the zakat due from the Islamic bank as well as amounts of zakat received from other sources of funds shall be presented in the statement of sources and uses of funds in the zakat and charity fund (para 12).

In the MASB TR *i*-1, presentation of zakat is highlighted 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".

The fourth is related to disclosure. In this regard, FAS 9 set up eight rules about disclosure, which include the obligation to make available in notes accompanying the financial statements:

- (1) “method used for determining the zakat base and the items included in the base” (para 13).
- (2) “the ruling of the Sharia’s supervisory board of the Islamic bank on issues related to zakat that are not included in the standard” (para 14).
- (3) “whether or not the Islamic bank as a holding company pays its share of zakat obligations in its subsidiaries” (para 15).
- (4) “the amount of zakat that is due from each share (if the bank does not pay zakat)” (para 16).
- (5) “the amount of zakat that is due from the equity of investment account holders” (para 17).
- (6) “whether or not the Islamic bank collects and pays zakat on behalf of holders of investment accounts and other accounts” (para 18).
- (7) “the restrictions imposed by the *Shari’a* supervisory board of the Islamic bank in determining the zakat base” (para 19).
- (8) In addition, in the last paragraph (i.e. para. 20) of the 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” (MASB, 2004).

The disclosure requirements are set up in points 16 and 17 of MASB TR *i-1*. The requirements are much simpler than the rules that govern FAS 9. It states, for example, the entity shall disclose in the notes accompanying the financial statements: method used in the determination of zakat base; its responsibility towards payment of zakat on business; and major components of zakat. It is further stated that components of zakat may include: current zakat expense; zakat payment; zakat liability; and any adjustments recognized in the period for zakat of prior periods.

4. An examination of some concepts

After reviewing issues related to definition and classification of account, recognition, measurement, presentation and disclosure, this paper will now examine these issues in the context of their conceptual dimensions.

4.1 Definition and account classification

In FAS 9 of AAOIFI, it is noted that although zakat is defined only in the Appendix (D: Juristic rules for zakah, p. 322, 2001), this generally accepted definition serves as an important reference in commencing the standard. The definition of zakat as provided by AAOIFI can be considered as an appropriate definition and reflects the substance of zakat. In fact, equivalent definitions are also being used by numerous authors (Al-Qardawi, 2004; Muhammad, 1980; Sabiq, 1985; Abdul Rahman, 2007). Nevertheless, despite the fitting definition of zakat offered, it is unfortunate that zakat paid has been inappropriately regarded as “an expense” in the very same standard.

This plain treatment of zakat paid as “an expense” is indeed against the very substance and spirit of zakat itself. This is based on the following justifications. First is pertaining to the concept of ownership in Islam. It is very clear in the view of Islam that

the real owner of everything in this world is *Allah* alone (see, for example: *Al-Quran* 2:115,116, 191, 284; 42: 4, 12, 49, 53; 43:83; 45:27; 48: 7, 14 and that wealth given by *Allah* is in trust (Al-Ghazali, 1983, p. 80)). The proprietors, who are mere trustees, are constantly reminded of the fact that they are in reality simply agents appointed by God to administer their holdings (Adnan, 1997). Accordingly, Abdalati (1980, p. 128) emphasized that the proprietor must always be ready to spend in the way of God and to contribute to worthy causes. Further, zakat also is meant to purify the wealth of the payers, since in part of their wealth lies some portion which is the right (or due) of others, and thus needs to be delivered to the latter (*Al-Quran* 17:26, *At-taubah*:104). It is thus argued here that zakat payment is purely a manifestation of submission to *Allah*'s clear instructions to return the temporarily deposited wealth to the rightful owner; hence zakat does not constitute an expense in any way.

However, it needs to be noted that if one looks at wealth or company's ownership from the normal conventional perspective whereby a company is fully and exclusively owned by its shareholders, the current accounting treatment of zakat would fit well to that view. This is because any payment of zakat deprives the owner of funds and therefore should be appropriately shown as expense, reducing the income available to pay shareholder dividends.

The next justification is concerning the definition of zakat itself. As discussed earlier, one of the literal meanings of zakat is "growth" and "increase". Growth can be seen from various perspectives. This includes both psychological growth and material growth. Similarly, increase can also be interpreted in many ways including increasing the payer's good deeds resulting in an increase in their religious merits and blessings (Abu Bakar, 2008). Not only that, on the recipients' side there will be growth or increase in their wealth too. Further, in the *Qur'an* Chapter 2:261, *Allah* has described the multiplier effect of wealth paid according to His way (which includes zakat) to be 700 times[2]. This has actually been confirmed by many Muslim economists (Zaim, 1989) whereby they argue that zakat has a multiplier effect to the economy. Zakat is said to be able to gradually eliminate poverty and consequently, unemployment. Income will be increased thereby increasing standards of living and thus eventually enhancing the aggregate volume of zakah collection.

According to another perspective, some scholars argue that increase will also be implicated in the payer's wealth. In other words, whoever rightly performs zakat obligation would be given an increase in his or her wealth. Simply put, any asset or amount paid as zakat is promised to grow significantly, in many different aspects – including spiritual, psychological and financial – benefiting payers as well as the entire economy. The distinctive nature of zakat does not therefore permit it to be treated as a mere "expense" since it represents two diverse concepts.

The third justification is in connection with a well-acknowledged *hadith* narrated by Bukhari and Muslim, whereby Rasulullah (*pbuh*) recalled that all rewards will be cut-off after death, except for three things, namely: *shadaqah jariah* (which includes zakat), the knowledge shared and utilized by others, and the saleh off-springs who make the *do'a* (call) for their parents. This *hadith* indirectly signifies the dissimilarity between zakat and other payments.

Zakat payment is basically the payers' real (if not eternal) "asset". Taking into consideration all of the above issues, it is thus not acceptable to regard zakat payment as merely like any other obligation payment. Zakat is unique and distinct in both its

concept and implications. The inappropriateness of treating zakat as one type of expense can be further demonstrated by thoroughly analyzing the concept of expense from a general accounting understanding.

From an accounting perspective, there are many definitions of expense. Perhaps, the simplest definition can be seen at: 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 is referenced in the *Free Financial Dictionary*. (<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 taxable income. Notes: Expenses are the opposite of income. Costs that are not deductible are called “capital expenditures” and must be depreciated or amortized instead.

Again, it is difficult to see how zakat can fit into the above definition of expense since zakat is neither intended to continue the ongoing operations of a business nor is it meant for the purpose of capital expenditure. It is also not a payment that can be deducted only from income, because zakat determination may also be based on assets. It means that in certain conditions, although the company has not earned the income, as long as the total net assets value achieves the *nisab*, the obligation to pay zakat has arisen.

More definitions of expense (as they are evolving 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 (AICPA, 1955, ARS No.3).

Expense in the broadest sense includes all expired costs which are deductible from revenues (Committee on Terminology, Accounting Terminology Bulletin No. 4: Proceed, Revenue, Income, Profit and Earnings, AICPA, para. 31).

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).

Expenses are outflows of others using up of assets or incurrences of liabilities (or a combination of both) during a period of 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).

Expenses 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).

The only basis upon which one might argue that zakat paid is actually an expense is that zakat paid shall decrease the assets or, increase the liabilities, or a combination of both. Even for this type of argument it is inappropriate to regard zakat as an expense due to the underlying purpose behind zakat payment (the purpose of cash outflow),

which is distinct in nature and inequivalent to any other type of expense as defined above.

Thus, far, definitions of expense provided are those taken from conventional or Western accounting thought. The examination of classifying zakat account can also be scrutinized from the conceptual framework promulgated by an Islamic accounting authority like AAOIFI. Below is a definition of expense as provided by the AAOIFI (2001b, SFA No. 2; para 33):

Expenses 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.

Unlike the definitions cited from the conventional Western sources above, the AAOIFI adds to the expense definition, the following characteristics:

- 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.
- The gross decreases in assets or the gross increases in liabilities should have the same characteristics of assets and liabilities.
- The gross decreases in assets or the gross increases in liabilities should relate to the period covered by the income statement.

As pointed out earlier, the payment of zakat is basically an act of transferring back the temporarily trusted wealth to the real owner. The first criterion stated above is not, and can never be, fully matched. In other words, the classification of zakat as an “expense” (operating or not) is not acceptable to Islam. The existing classification found both in FAS 9 and MASB TR *i-1* should be consequently refused. The question then is: how to treat zakat more appropriately?

Since it is payment with a special purpose (i.e. to fulfill one’s obligation towards the real owner of wealth by delivering the trusted wealth to the designated categories of people), it is then sensible to classify it under the item which represents payment to “temporary owners” (i.e. the beneficiaries of zakat). The closest category of item available in the present financial statements that matches the criteria of such payment is essentially the dividend. It is therefore proposed that zakat payment shall be treated in the same way as a dividend, instead of as a non-operating expense, or any other type of expense. It is believed that the former treatment is much more relevant than the latter. This notion is in line with other views proposed by Khan (1994), Al-Habshi (2005) and Nasir and Hasan (2005).

4.2 Recognition

The recognition in accounting refers to the determination of time to record a transaction (SFA No. 2, para 81). The FAS No. 9 does not specifically address the recognition issue with regards to zakat. However, as the principle of *nisab*[3] and *hawl*[4] are fully acknowledged in one of its appendices (i.e. Appendix D), it is presumed that the recognition concept shall be based on these two principles. In other words, the recognition of zakat is subject to the fulfillment of *nisab* and

hawl requirements. There appears to be no arising issue on this matter both in the FAS 9 and TR *i-1*.

With regards to measurement, The SFA No. 2, para. 82, 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.

It is generally understood that measurement pertaining to zakat is about the determination of amount of zakat liable to the zakat payer. It has been reviewed in the previous section that both FAS No. 9 and TR *i-1* offers two different methods. Both accounting bodies have also stated that each method would yield a similar zakat base (as long as the accounts involved are consistently treated periodically). The only dissimilarity between the methods proposed by these two bodies is that the FAS 9 is for Islamic financial institutions, while the TR *i-1* can be used for any business organization.

The essence of calculation methods offered by each accounting body also seems to be comparable, although the labels given are different. However, there are some problematic issues when measurement is integrated with the expense concept. Let us take the net invested fund method as proposed by FAS 9, or the adjusted growth method as set up by the TR *i-1*. The zakat base in each method is determined, based on (among others), the value of equity account, which includes yearly net income; that is the income statement needs to be ready first, otherwise a zakat base could not be determined. This is paradoxical since zakat has been treated as an expense by the very same standard or pronouncement and this "expense" as we know constitutes a major part of the income statement. It is unclear whether in the calculation of net income the "zakat expense" has been accommodated. While trying to rationalize this method, there are at least two possibilities: the first being that zakat has been expended and has subsequently reduced the value of net income. However, the question is: what was the basis used to determine the "zakat-able" amount?

The other possibility is that zakat expense has not yet been included in the net income calculation. This means that the net income figure is the net income before zakat, which is presumably used as the base for zakat calculation. If this is the case, it means that some part of the standards (in both FAS 9 and TR *i-1*) have been neglected. This implies that those two standards are in error owing to conflicting components.

4.3 Presentation

In terms of presentation, as zakat is thus far treated as either a non-operating expense or a normal expense, both FAS 9 and TR *i-1* stated zakat to be presented as any other expense account. This means that 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 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 a consequence of assuming zakat to be similar to an expense. However, since the treatments proposed by both FAS 9 and TR *i-1* are not acceptable, then the presentation should also be adjusted.

As stressed earlier, based on both Islamic accounting points of view, zakat can be recognized as a type of distribution, instead of an expense. Again, the item in the financial statement that is closest to this notion of distribution is dividend. It is appropriate then to follow the manner on how dividend is presented. 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 earnings. This approach of presentation is actually 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.

4.4 Disclosure

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

Examining requirements set by the two accounting bodies confirms that those requirements are considered logical and acceptable. They are conceptually satisfactory and practicable. The only arising problem with disclosure requirement is that the commitments and/or compliance of institutional zakat payers with those requirements. Based on a cursory examination, many companies in Malaysia only present zakat as an expense and provide no elaborative disclosure as required by the existing standards. Obviously, this is one of the many challenges that need to be resolved by related authority bodies in the near future, particularly in their efforts towards promoting an enhanced disclosure in companies' financial statements.

5. Challenges ahead: possible lack of comparability

Besides the above, another challenge that needs to be addressed here is the possible lack of comparability that will be introduced into accounts if Islamic companies are required to pay zakat, and assumingly then treat it as an ownership distribution rather than as an expense (owing to their outlook on the wealth ownership). This issue is relevant particularly if there is no effort to standardize the accounting treatments for corporate zakat among all corporations, which is part of the standard-setters' "responsibility".

It is thus argued here that should the proposed alternative accounting treatment for corporate zakat be followed, there should also be a mechanism and initiatives to standardize the system. One possible initiative is through the issuance of zakat accounting standards (ZAS), which will govern the accounting treatment for corporate zakat. It is expected that ZAS may enhance the uniformity and comparability of business financial statements with those of others within related industries (Abu Bakar, 2007; Abdul Rahman, 2002). This uniformity and comparability will in turn assist the auditing process of zakat accounts (Abdul Rahman, 2007, p. 92).

Another possible positive implication of the issuance of ZAS is that it may contribute towards an increase in the amount of a business' zakat collection (Abu Bakar, 2007). However, currently there is no empirical evidence to support this assertion.

6. Concluding remarks

This paper has critically reviewed the accounting treatments for zakat of business organizations, particularly the two standards or technical releases issued by the AAOIFI (i.e. FAS No. 9) and the MASB (i.e. TR *i*-1). They were examined both from the substance of zakat understanding and the accounting conceptual framework. This included definition and classification, recognition, measurement, presentation and disclosures. Two conceptual discourses were referred to: Western or conventional accounting, and the Islamic one, as issued by the AAOIFI.

Two fundamental objections were raised accordingly. One is the definition and recognition of zakat. In turn, this relates to the presentation. The other is the issue of measurement or determination of zakat. It is important to recognize though, that the alternative viewpoint brought forward in this paper arises owing to the different initial perspective of how ownership of wealth is viewed, whereby it is emphasized that Allah is the ultimate and real Owner of all wealth, and thus any accounting treatment for corporate zakat, should reflect this.

Overall, this research hopes to shed some light on a few potential areas of improvements for the present accounting treatment for corporate zakat, which may be worth considering by the respective standard-setters. This is of importance as it has an effect on not only the technical aspects of zakat accounting, but also the behavioral impact on zakat payers.

Notes

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 (www.answers.com/topic/hadith).
2. "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" (*Al-Quran* 2:261).
3. "Nisab is the minimum amount not liable to the payment of zakat" (AAOIFI, 2001c, p. 323).
4. "... is the passing of a lunar calendar year, starting on the day on which the nisab is attained" (AAOIFI, 2001c, p. 323).

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