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Business Zakat Conditions and Their Relationships with Accounting Principles: An Exploratory Study

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In current practices of business zakat computation, information from financial reporting disclosure is prepared based on accounting principles. However, there are problems as the business zakat conditions require different information from what is being disclosed in financial reporting. This creates difficulties as the current accounting practices cannot fully meet the demand of information required for business zakat computation. As the need of zakat accounting is undeniable, this study goes beyond the normal study by concentrating on each condition of business zakat and how it relates with current accounting practices. It is an exploratory study designed to discuss the current gap between zakat conditions and accounting principles. This study has revealed the gap occurring between the practices are due to two reasons, (i) the different in definition used by the practices and (ii) shariah requirement that is not within the scope of accounting.

Key words: *Accounting for Zakat, Zakat Conditions, Harmonising Accounting and Zakat.*

Background of Study

Malaysia recognises the importance of business zakat as part of national fiscal system. In 2005, the government allowed business zakat payment as a deductible expense at a maximum rate of 2.5% from the business's aggregate income. Accordingly, in 2006, the Malaysia Accounting Standard Board (MASB) realised the needs of standardisation in accounting treatment and financial reporting disclosure and had issued the accounting pronouncement for business zakat, namely MASB TR i-1 *Accounting for Zakat on Business* (MASB, 2006).

However, the accounting pronouncement, MASB TR i-1 is limited in nature (Abu Bakar, 2007). It was issued as a technical release, which serves as a technical guideline rather than a standard. It only covers the accounting treatment and disclosure of zakat for businesses that made zakat payment. No disclosure is needed if a business does not pay the business zakat. Thus, the MASB TR i-1 does not have an allocation on the accounting information disclosure to assist the business zakat's computation and payment.

This issue has been discussed regularly by previous research but is still unresolved until today. In fact, most of studies regarding accounting for zakat discusses the issuance of zakat regulation or standard of accounting zakat (Alim, 2015). At the end, the sphere of zakat accounting studies seems to revolve around the same issues. Rather than discussing the standard for zakat accounting, this study focuses on zakat conditions themselves and their relationships with accounting practices. This is to tackle the specific problem in fulfilling the information needed for zakat computation.

Statement of Problem

Currently, to calculate business zakat, a financial report with other internal information is required. This internal information is normally gathered from a discussion with the personnel from the finance department. This is because the information disclosed in financial reporting in its current form cannot fulfil some of the information needed for zakat computation (Abdulah, Mohd Rizuan, & Abdul Aziz, 2012; Syed Mohd Ghazali Wafa, 2006).

The jurists have agreed that business zakat should be based on *urud al-tijarah* (tradable goods) (Al Qaradawi, 2011; Al-Zuhayly, 2002; Ash Shiddieqy, 1996) and is expanded by the use of the net working capital (Ismail, Tohirin, & Ahmad, 2013; Syed Mohd Ghazali Wafa, 2006). Unfortunately, the current accounting practices still lack the information needed for zakat purposes.

The situation is bad as zakat; an act of subordination to God Almighty, must be paid either by the company or the shareholders (E-Fatwa, 2009; Mohd Saleh, 2006). Therefore, the information required for business zakat computation must be disclosed, as the zakat payment for business must be fulfilled, in one way or another.

Since accounting cannot fully satisfy the information needed for zakat computation, the exact required information needs to be highlighted. A thorough study is needed to look at the zakat conditions to determine what exact information is needed. Hence, this study is designed to outline the common and pertinent conditions of business zakat that are related to the accounting principles.

The Study Design

This study is an exploratory study conducted for the purpose of obtaining a clear idea in the area of study. Currently, zakat issues, especially those of business and accounting disclosures, need further improvement (Abdul Rahman, 2007; Adnan & Abu Bakar, 2009; Syed Mohd Ghazali Wafa, 2006). The current structure for accounting and zakat disclosure needs to be enhanced to reflect the information needed for zakat purposes.

The process of exploration in this study is through reviewing books, journals and annual reports. The review on zakat conditions is completed through studying books from well-known scholars, written either in Malay or English such as Abdullah (1997), Abu 'Ubayd (2007), Al Qaradawi (2011), Ash Shiddieqy (1996), Atiyah (1995), Sahata (2003), Ibn Rushd (1994), Zayas (2003), Masyur (2002) and Sabil (2005) as well as contemporary Malaysian scholars such as Hamizul (2012) and Hasan, Abdul Halim, & Rawi (2011).

The purpose of reviewing these books is to understand the basis of shariah conditions for business zakat. These books are also used as a reference to understand zakat issues raised by the current researchers. Meanwhile, journals are used to understand, the overall issues on current business zakat practices and the solution proposed on such issues.

Finding and Discussion - Business Zakat Conditions and its Relation with Accounting Practices

It should be noted that the rule of zakat is progressive and dynamic, as it follows the societies economic development (Abu Bakar, 2007). For example, during the period of Prophet Muhammad (PBUH), only five items were subject to zakat and had expanded as time passed. The reason behind the changes was due to principles of zakatable items. The environment and economic conditions have changed over time, but the principles of zakat have remained. The findings about zakat conditions and their relationships with accounting are discussed in the following sections below.

(i) Muslims

The first condition of zakat is that it is imposed strictly on Muslims. There is an agreement among the jurists on this matter (Al Qaradawi, 2011). Non-Muslims are not obligated to pay zakat because zakat is part of Islamic worship and not collected from the non-believers.

However, the problem arises when the business has a mixed ownership of Muslims and non-Muslims. In such cases, the information about the ownership portion of the Muslims and non-Muslims must be gathered. The situation can become complicated when the shares are also held by entities. If this happens, then a reasonable estimation is needed to determine the portion of the Muslims' shares in those entities.

Currently, especially for the public companies, there is no absolute way to determine the Muslims' share portion. The zakat paid by public companies is based on the estimation of Muslims' share portion.

(ii) Complete Ownership

Complete ownership is the ownership of both a property and its usufruct (Al-Zuhayli, 2002). It gives the owner all possible legal rights associated with the owned assets and it is unconditional and has no time limit as long as the assets continue to exist (Al-Zuhayli, 2002). State of ownership is very important in assessing zakat.

In current accounting practices, there is no detailed ownership concept applied. However, due to the importance of information, these items can be extracted in the statement of financial position, which is assessedd through an explanation in the notes to the account.

(iii) Potentially growth Assets

The word zakat also means growth and every growing wealth is zakatable (Al Qaradawi, 2011). The assets that are eligible to zakat, must either have actual growth or the potential to grow (Sayed Sikandar & Wok Mek, 2011). In conventional practices, the commodities invested in the business are known as the working capital (Sahata, 2003). Working capital always circulates and is replaced in the business, to generate a profit (Ishmael & Kehinde, 2013). It is very important to control the working capital effectively and efficiently as it can provide the firm with a maximum return (Makori & Jagongo, 2013).

Accounting classifies current assets and liabilities as working capital. For zakat purposes, the only items in a working capital are subject to zakat. The working capital which have elements of growth is zakatable (Al Qaradawi, 2011; Ash Shiddieqy, 1996). Basically, all the zakatable items are those items classified as working capitals in accounting. However, it should be noted that not all working capital items are zakatable.

To determine the zakat eligibility for working capital items, classification of items into monetary or non-monetary is needed. Monetary items are defined as 'units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency' (MFRS121, 2012) and as 'money **held and items to be received or paid in money' (MFRS129, 2012). Meanwhile the non-monetary items are**

those that do not match the monetary criteria (Tan Liong Tong, 2013) such as property for development and inventories.

For the non-monetary items, only items that are ready for sales are deemed to have potential growth criteria. Therefore, only inventories or properties that are ready for sales are subject to zakat. Currently in accounting disclosure, the detailed on non-monetary items such as inventories and property investments can be extracted from the notes to the account. Thus, the information about potential growth of non-monetary items for zakat purposes can be gathered.

The monetary items in the working capital are the money held or items held to be received in a determinable amount of money. These items are normally cash or cash equivalent held to be circulated in sales activities. A cash item is growth, because it is the means of exchange and measures value as a substitute of goods (Al Qaradawi, 2011). When cash is used in business it brings income, which indicates growth. These items meet the potential growth criteria as it is used in the circulation of sales activities and generates profit for business.
Confusion may arise when there is an excess of cash in the business. The excess cash is converted into other instruments to earn more return, such as short term investments. Thus, for an item to be zakatable, the cash that is converted into other short-term instruments which retains its criteria in fulfilling the role of circulation and production. The short term instrument will be liquid so it can be converted into cash quickly and at a low cost, or without significant lost in value (Gopalan, Kadan, & Pevzner, 2012). If these criterions are not met, it is not cash equivalent and not zakatable.

Therefore, to be eligible for monetary items or cash items charged to zakat, it must have the ability to fulfil the role of circulation and production. This can only be done if the business owner has full control over the liquid items. The incapability to benefit from the asset indicates that it is not zakatable (Al Qaradawi, 2011). Thus, the monetary items, must be liquid and controllable for zakat eligibility. Currently, the detail about the control of liquid items can be extracted from the notes to the account.

(iv) Reach the Period (*Haul*)

For an asset to be zakatable, it must reach a year of ownership, unless stated otherwise by shariah. Ash Shiddieqy (1996) stated, the wealth that must reach a 12-month period include: cattle, gold and silvers, tradable goods or the wealth which otherwise not mentioned by the hadith.

According to the FAS 9[1], business zakat needs to be calculated yearly, using the *hijrah* calendar (a lunar calendar consists of 354 or 355 days a year). However, the Malaysian Fatwa Council has also agreed that the *masihi* calendar (a sun calendar consists of 365 or 366 days a year) can be used. The rationale given on using the *masihi* calendar is that, the assets are further accumulated for a few days, using the same rate (Atiyah, 1995). This concept is in line with the accounting period concept which accounts the need to be closed every year to assess business performance. Therefore, in applying this concept, there will be no significant changes in accounting practices.

(v) Minimum Exemption Limit (N*isab*)

For the *nisab* of business zakat, Muslim scholars agreed that *nisab* is equal to two hundred of dirham of silvers or eighty five grams of gold (Sahata, 2003). From an accounting perspective, *nisab* can be determined at a yearly base on the prepared financial position. The condition of *nisab* on the business assets is determinable, without any adjustment to be made. Thus, for *nisab*, no changes in accounting practices are required.

(vi) The *Halal* Source

Zakat is taken only from the *halal* source. In today's modern business, sources of income can be derived in many ways. In Islam, the principles of *halal* and *haram* are clearly stated and it is agreed by the jurists that unlawful sources are not zakatable (Al Qaradawi, 2011). For example, the prohibition of income derived from commercial transaction with the elements of interest, production and sale of alcoholic substances, gambling, hoarding and deceptive purchases (Jasri, Naaishah, & Hasani, 2010).

Based on the zakat guide book issued by Lembaga Zakat Selangor (2007), it states the "Properties that are subject to zakat are only those of *halal* sources. All the non-*halal* sources, whether in essence such as alcohol and pork, or businesses that conduct illegal activities such as gambling and usury, zakat are not obligated. For entities that have mixed *halal* and non-*halal* source, only the *halal* portions are zakat assessed". Therefore, practices of zakat authorities in Malaysia are clear, all the non-*halal* sources need to be removed from zakat computation, including the interest received from conventional banking.

Currently in accounting practices, the separation between *halal* and non-*halal* source is not there. From an accounting record, this information can be gathered and separated. However, it is the norm of accounting reporting that this information is not being disclosed. Therefore, it is suggested the information on the separation of *halal* and non-*halal* sources can be practiced in accounting reporting for zakat computation purposes.

(vii) Chargeable Upon Mature

[1] Zakat Standard applicable for IFI issued by AAOIFI, an international accounting body.

Zakat is imposed on an asset once it is mature. Ash Shiddieqy (1996) said that Imam Malik, Imam Ahmad, al-Auzai, al-Ishaq and Abu Ubaid have all agreed that if an asset has reached the *nisab*, but is sold or grant to others before reaching the *haul*, or it is destroyed, the zakat is still required. For business assets that are transferred out at the end of the year, it is still zakatable as the asset has matured. However, if this is done at beginning or middle of the year, it is not zakatable because the assets are yet to mature.

Based on the zakat computation practices in Malaysia, the amount of matured assets that has been disposed need to be added back (Lembaga Zakat Selangor, 2007). These assets are normally disposed as an expense to finance, other assets or given as donation. It is considered mature when the disposable takes place a month before the year-end. In accounting practices, this information is considered as immaterial and the details of the transactions are not disclosed. However, to enable zakat computation, this information is needed.

(Viii) Overall Findings on Zakat Conditions and its relationship with accounting reporting
based on the discussion on zakat conditions, it shows that most of the information required for zakat assessment is available in the financial reporting. However, the information requires further reviews through the examination on the notes to the account. Thus, the information required for zakat needs to be rearranged to facilitate the computation. However, there is some information such as *halal* and non-*halal* source that is not available. To extract this information an internal assistant is needed. From the discussion about zakat conditions and the information required from accounting to facilitate zakat computation, it has been summarised in Table 1 below:

Table 1 Zakat conditions and its relation with accounting reporting

No	Zakat Conditions	Information Required	Accounting Measurement	Zakat to be assessed	Availability in Accounting Reporting
1	Zakatable to Muslims	Portion of Muslim equities	-	-	Analysis of shareholdings
2	Complete Ownership	Undividedness of ownership	Assets being held considered as controlled	Only full ownership with characteristic of controllability	Statement of financial position and notes to the accounts
3	Growth Potential Assets	Either of actual growth or have the	Classified as assets - items in working capital	Items in working capital that are	Statement of financial position and

		potential for growth		full control	notes to the accounts
	• For non-monetary items	Goods ready for sale (*Urud al-tijarah*)	Inventories to be sold recorded as current assets (valuation using approved MFRS)	Only for goods ready for sale (valuation based on accounting record)	Statement of financial position and notes to the accounts
	• For monetary items	Cash and cash equivalent	Cash and short term instruments at current assets	Instruments that are controllable and liquid	Statement of financial position and notes to the accounts
4	Reach the Period (*Haul*)	Complete one year period	One year cycle based on solar year	One year cycle based on accounting financial year	Financial reporting year end date
5	Minimum Exemption Limit (*nisab*)	Based on 85g value of gold determined by zakat authority	n/a	n/a	n/a
6	The *Halal* Sources	Information on *halal* sources	Nil – no separation	Only *halal* sources are zakatable	Nil (not being practiced) – needs for internal information
7	Chargeable upon mature - disposal of zakatable assets	Assets acquired or donation given at the end of *haul* - date of transactions	Accounting record – journal entries	Date of transactions take place	No disclosure - needs for internal information
8	Discretionary in Zakat Assessment	Some of items in financial position that need discretionary such as inventories, investment	Critical accounting estimates and judgments	Follow accounting valuation and *amir* judgment	Statement of financial position, notes to the accounts and internal information

From the discussion of zakat conditions and and its relation with accounting reporting, the gap between the information needed for zakat computation and current accounting practices is due to two reasons, different definition used in the practice and shariah requirement that required practices must adhere to.

Conclusion

Although jurists have determined the conditions of zakat, they are still dynamic within the stipulated limit. This room shall be utilised to make the zakat conditions, as close as possible to accounting practices. Meanwhile for standard accounting practice, it is developed based on social acceptability. Accounting accepts the existence of different segments in society, where each segment has different interests about business performance (Pattillo, 1965). This is how accounting standards are developed, i.e. by fulfilling the needs of society. This shall include the need for information to compute business zakat.

In this study, it reveals there are two important factors that cause the gap between practices. First, most of the information required for business zakat computation can be extracted from financial statements. However, when it comes into detailed requirements such as information about complete ownership and growth potential assets, notes to the account need to be assessed.

Second, there is information needed for business zakat computation, but this information is not within the scope of standard accounting practices. Information about *halal* and non-*halal* sources are not being practiced in accounting standard. From an Islamic perspective, this is a noble practice. In fact, this practice might attract more investors and bring a good name to the business. Meanwhile, information about disposal of zakatable assets at year-end is also a good practice. This practice will show the utilisation of assets by a business at year-end.

Thus, it is recommended that this practice shall be considered to be embedded in accounting practices. It may be disclosed through voluntary disclosure in financial reporting.

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