Current Methods of Business Zakat Accounting in Malaysia

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ABSTRACT
Zakat on business is one of the highest contributors in the total of zakat collection in Malaysia. Assessment of business zakat should be calculated accurately and correctly by using appropriate accounting method that suit with the nature and characteristic of businesses. The accounting methods used by zakat institutions contributed to various business zakat models. This study is to identify the business zakat accounting methods adopted by Lembaga Zakat Selangor, Pusat Pungutan Zakat, Wilayah Persekutuan and Majlis Agama Islam Negeri Johor and to identify differences between the methods used. The Adjusted Working Capital Model, Adjusted Growth Capital Model and Profit and Loss Model are among the prevalent models adopted by business entities in Malaysia. By performing content analysis technique, it is revealed that business zakat accounting methods in several states are not rigid and can be modified from time to time. This study is expected to provide guidance to institutions of zakat in respect of the diversity of current accounting methods in assessing the zakat on business.

Keywords: Business Zakat, Zakat Accounting, Zakat Institutions, Assessment, Assets and Liabilities

ABSTRAK
Zakat perniagaan merupakan antara penyumbang tertinggi dalam kutipan zakat harta di Malaysia. Taksiran zakat perniagaan perlu dikira secara tepat dan betul dengan menggunakan kaedah perakaunan yang bersesuaian dengan perniagaan yang dijalankan. Kaedah perakaunan yang pelbagai yang digunapakai oleh institusi-institusi zakat telah menyumbang kepada...

Kata Kunci: Zakat perniagaan, perakaunan zakat, taksiran, aset dan liabiliti.

INTRODUCTION
Zakat on business is one of the zakat imposed on properties with the intentions of trading. It covers a wide range of business sectors namely industrial products, consumer products, construction, plantation, infrastructure, trading and services. The zakat is imposed on different types of business entities whether sole-proprietorship, partnership, private companies, public companies and cooperatives.

It is interesting to note that zakat is calculated based on the net wealth of the business at hawl completion regardless of whether the business is making profit or suffering losses in one accounting period. Once the entities fulfilled all the business zakat condition, the obligation towards zakat is incurred.

Basically, the conditions of properties subject to zakat are almost same. However, for zakat on business, there are several other conditions need to be fulfilled by the business entities. The 31st Muzakarah (Conference) of the Fatwa Committee National Council of Islamic Religious Affairs Malaysia held on 9th December 1992 has discussed zakat on business. The Conference has decided that a business entity is obliged to pay zakat when it fulfils these conditions namely the business is owned by Muslims, the business is owned by free Muslims, complete ownership, the amount of the wealth reaches the minimum zakatable limit (nisab), the wealth has been possessed for one lunar year (354.3 days), the zakat rate on business is 2.5%; and as for the business shared by Muslims and non-Muslim, only the share owned by the Muslim is zakatable. The zakat is calculated based on the net wealth obtained (http://www.e-fatwa.gov.my).

Business zakat accounting was formed generally based on al-Quran, al-hadiths, al-ijmak ulama and al-qiyas. Thus, there are a variety of business zakat accounting methods used by business entities (Zahri, H. 2014). Generally, there are six business zakat accounting models used in Malaysia (Zahri, 2014). The models are current assets method, working capital method, adjusted working capital method, working capital method plus investment income, capital plus profit method, and income or profit method. However, only several methods such as adjusted working capital method and profit method are being used by zakat institutions in Malaysia in calcuting business zakat. Finally during the National Zakat Convention in 2001, adjusted working capital method has been accepted as the most prominent and applicable method to compute business zakat payable.
Working capital model, growth capital model and profit model are among the prevalent models adopted by business entities in Malaysia. Working capital model is accepted as the most closely complied with the Shariah principles and it has been supported by several jurists (al-Qaradawi, 1999). However, Zahri, H. (2014) found that working capital model used in computing business zakat is not relevant for all business entities. This is due to several reasons such as some business is having too much short-term loans which resulted in negative working capital. Alternatively, business entity is suggested to use growth capital model in computing its business zakat. Besides that, the valuation of business inventories which based on historical cost is not suitable because goods should be valued at market price. Therefore, accounting valuation should be adopted by business entity to compute business zakat. The valuation method used should be disclosed in the business’ annual report. Accounting valuation is an essential element in assessing the business zakat accurately. In calculating the amount of zakat payable, assets need to be valued by the business occasionally (Ahmed et al., 2016). This is vital in ensuring the accuracy of zakat computation and in compliance with Shariah principles. Then, several methods for business zakat accounting are referred in order to arrive at zakat payable amount.

This study aims to explores business zakat accounting methods adopted by Lembaga Zakat Selangor, Pusat Pungutan Zakat, Wilayah Persekutuan and Majlis Agama Islam Negeri Johor and to identify differences between the methods used.

**EVIDENCES ON BUSINESS ZAKAT**

The obligation of zakat on business is derived from several evidences from al-Quran, al-hadiths, al-ijmak ulama and al-qiyas. The most prominent verse regarding zakat on business is as follows: Allah S.W.T says, "**0 you who believe! Spend of the good things which you have earned, and of that which We have produced from the earth for you and do not aim at that which is bad to spend from it, (though) you would not accept it save if you close your eyes and tolerate therein. And know that Allah is Rich (Free of all wants), and Worthy of all praise**"

(al-Baqarah : 267)

According to al-Tabari, (Muhammad, 2000), "**spend of the good things which you have earned**" refers to economic activities such as the business sector. Thus, business entities are obligated to perform zakat on what they have put on their efforts in generating income and profit. At the same time, the business entities have to ensure the business assets must be from halal sources and all the business activities too must come from halal activities or services. Imam al Ja'assas and Imam Abu Bakr ibn al 'Arabi have been reported to assert the same opinion which zakat is obligatory on the trading activities (Al-Qaradawi, 1999: 204).

Hadith from Rasulullah s.a.w as narrated by Abu Dawud reported from Samurah ibn Jundub, "**The Prophet (s.a.w) used to order us to pay the sadaqah (zakat) on what we have prepared for trade (urud al-tijarah)**"

(Abu Dawud, 1557)
The above hadith clearly stated that zakat is obligatory on goods or inventories which are ready to be sold. Prophet s.a.w gave an order to perform zakat on business inventory. Many jurists referred business inventory as urud al-tijarah, which means any commodities obtained for the purpose of resale for profit (Abu Bakar, Ibrahim & Md Noh, 2014). However, some jurists defined urud al-tijarah differently and it has contributed to various business zakat accounting methods used by business entities (Zahri, 2014).

Ijmak ulama related to zakat obligatory is as reported by Aby Ubayd (1991). There is a report from Abu ’Amr ibn Hammas, from his father, who said:

“Umar passed by me and said, ‘Oh Hammas, pay zakat of your possession (wealth)’. I said, I’ have nothing except hides and bags. He said, "Determine the price of these things and then pay their zakat"


Abu ’Ubayd al-Qasim (1991) reports the ways of calculating zakat as perceived by some of the great followers. He quotes Maymun ibn Mahran as saying,

“When zakat is due, calculate the amount of money, add to it the value of inventory and the amount of debts on customers that you expect to be paid, sum the total, deduct whatever debts you owe to others and pay zakat on the net”.

(Kitab al-Amwal, 454, 1185)

With reference the above quote, the formula for business zakat computation is clearly mentioned and it is still in use until today. The formula actually represents on how to work out for net assets or working capital of the business. The working capital model recommended by JAKIM and JAWHAR for business zakat computation is found consistent with the formula from the above report. The zakat computation started with the current assets which are subject to zakat deducted with operational current liabilities. Then, the difference is equivalent to the net assets or net wealth of the business. It is then multiplied with the zakat rate of 2.5%.

Al-qiyas literally means to equate, to compare between two matters. It is the process of making comparison between a problem with no clear fiqh with the problem that has clear fiqh based on the same ‘illah (Zahri, 2014). With regard to zakat, according to Ibn Rusyd, business inventories are wealth which have a potential to grow (Al-Qaradawi, 1999). Assets eligible for zakat must be assets that are productive and can be developed (al nama’) or has the potential to develop which means that it is able to generate income and profits. It can be concluded that the stand is same as other wealth that subject to zakat such as agriculture, crops, livestock, gold and silver.

BUSINESS ZAKAT ACCOUNTING IN MALAYSIA

Previously, zakat authorities were found to be using several approaches to calculating zakat on business. Nonetheless, productive and successful efforts have been made by the authorities to streamline and fine-tune these approaches. The original text on business zakat assessment only instructs for zakat payment based on inventories or goods for sale. This refined approach has
been published by The Department of Islamic Development Malaysia (JAKIM) and adopted by almost all the state zakat authorities. There are two types of method for zakat on business i.e. ‘urfiyyah method and shar’iyyah method (JAKIM, 2001). Nevertheless, most popular method for the computation of zakat on business is based on the shar’iyyah that considers current assets and deducts current liabilities and makes the necessary adjustments at year end. Both the methods are derived from the Statement of Financial Position (Balance Sheet) with the resulting zakat payable being the same. Thus, both the models will need adjustments of the same nature. The formulas for zakat computation for both methods are as follows:

**Growth capital model (urfiyyah method)**
Owner’s equity + non current liabilities – non current assets -fixed assets – intangible assets +/- adjustments

**Working capital model (shar’iyyah method)**
Current assets – current liabilities +/- adjustments

Assets eligible for zakat must be assets that are productive and can be developed (al nama’) or has the potential to develop. It means that it is able to generate income and profits. Cash or a cash equivalent asset which is not restricted in its use are also subject to zakat. Only productive current assets are subject to zakat. Other examples of productive assets are closing inventories (end products), trade receivables, fixed deposits. For raw-material and work-progress inventories, they are not subject to zakat as they are not ready to be sold yet.

Current liabilities are another important component in computing business zakat. It is divided into two categories namely operating liabilities and financial liabilities. Operating liabilities will be deducted from current assets. These liabilities are the obligations of the business which are related to the main principal activities and operations of that firm. They come from the operational activities that have been benefited but payment has not been made and therefore not subject to zakat. Some examples of operating liabilities are trade creditors, accruals (accrued salaries/rental/utilities), tax payable, and audit fees payable. Financial liabilities which are non-operational liabilities will not be deducted from current assets. These liabilities are subject to zakat as the business entity has full ownership on those items. Financial liabilities include dividend payable, bank overdraft, financial lease and capital lease.

Non-current assets such as building, plant and properties are excluded from zakat calculation. They are exempted from zakat as that are not acquired for sale. Owners’ equity represents the capital and profit made by the business for the year end which are subject to zakat. These components are referred when growth capital model is used. Finally, adjustments or reconciliation should be made for certain items categorized as assets or liabilities. This is to ensure that zakat calculations made are truly fulfill the principles of syariah on the business assets to determine whether zakat is imposed or not imposed.

588
The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) FAS 9 sets out accounting rules related to zakat on business (AOOIFI, 2008). Basic equation to assess zakat on business is:

\[
\text{(Current Assets - Current Liabilities +/- Adjustments) } \times 2.5\% \times \% \text{ of Muslim Ownership Share}
\]

This basic equation is to be applied whether to assess zakat on sole proprietor, partnership or companies. As for hopeless debts from customer, they are not zakatable unless they happen to be paid back. Then, they must be zakated once only, on the basis of similarity with earned wealth that is zakated at the time it is acquired. It is obvious that liabilities are deducted from assets and only the net is zakatable.

**METHODOLOGY**

The objectives of this study is to identify the business zakat accounting methods adopted by Lembaga Zakat Selangor, Pusat Pungutan Zakat, Wilayah Persekutuan and Majlis Agama Islam Negeri Johor. Then, the differences between the methods are identified. Therefore, the research method used for this study is by conducting content analysis procedure. In exploring the business zakat accounting models used by the zakat institutions, the information on business zakat assessment are obtained from the websites and booklets. Three zakat institutions which are Lembaga Zakat Selangor, Selangor, Pusat Pungutan Zakat, Wilayah Persekutuan Kuala Lumpur and Majlis Agama Islam Negeri Johor, Johor have been selected for this study. The selection made is based on the highest zakat collection in year 2015. Lembaga Zakat Selangor has shown the highest performance of zakat collection for the year 2015 with a collection of more than 600 million. It is followed by Pusat Pungutan Zakat, Wilayah Persekutuan Kuala Lumpur with more than 500 million of zakat has been collected. Table 1 shows the total zakat collection of the three zakat institutions in year 2015. Besides that, the portion of business zakat of each zakat institution is also provided in Table 1. Majlis Agama Islam Negeri Johor recorded that 32.7% of the total zakat collection is made from the business zakat in year 2015.

<table>
<thead>
<tr>
<th>Zakat Institution</th>
<th>Total Zakat Collection in 2015</th>
<th>Total Business Zakat in 2015</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lembaga Zakat Selangor</td>
<td>RM627,225,101.00</td>
<td>RM117,192,350.00</td>
<td>18.7%</td>
</tr>
<tr>
<td>Pusat Pungutan Zakat, Wilayah Persekutuan</td>
<td>RM565,830,672.18</td>
<td>RM94,121,305.74</td>
<td>16.6%</td>
</tr>
<tr>
<td>Majlis Agama Islam Negeri Johor</td>
<td>RM239,931,006.61</td>
<td>RM78,352,872.53</td>
<td>32.7%</td>
</tr>
</tbody>
</table>

*Source: SPMJ JAWHAR, 2015*
FINDINGS AND DISCUSSION
Currently, there are three different models available for computing zakat on business in Malaysia. It is found that Adjusted Working Capital Model has been adopted by Lembaga Zakat Selangor, Pusat Pungutan Zakat, Wilayah Persekutuan Kuala Lumpur and Majlis Agama Islam Negeri Johor. The formula for computing zakat payable under this model is same for all three zakat institutions where net assets are to be calculated first. It is followed by taking into considerations the relevant adjustments to be made at year end or hawl completion. Then, the zakat wealth will be multiplied with the zakat rate of 2.5%. Pusat Pungutan Zakat, Wilayah Persekutuan Kuala Lumpur stated that the Adjusted Working Capital Model is suitable for public and private companies, cooperatives, enterprises and tradings as long as there is a classification of their current assets and current liabilities. The total current assets and current liabilities could be obtained from the Statement of Financial Position of the business entities. For adjusting entries, the explanatory note could be referred to or the information should be provided by the management to zakat institutions in assisting them to compute the zakat payable for business accurately.

For the Adjusted Growth Capital Model, it also shows the same trend where all three zakat institutions use the model to compute zakat payable for business. In addition, Pusat Pungutan Zakat, Wilayah Persekutuan Kuala Lumpur has clearly mentioned that the Adjusted Growth Capital Model is meant for financial and Islamic banking institutions, Takaful providers and companies which do not have a classification of their current assets and current liabilities.

Finally, Profit and Loss Model is only practised by Pusat Pungutan Zakat, Wilayah Persekutuan Kuala Lumpur. This is the latest model introduced and will be applicable in practice in other states in Malaysia. This model is suitable for businesses which do not prepare their accounts or financial statements such as small traders and retailers including sole traders, night markets traders, restaurant operators. The summary of the findings are presented in Table 2.

<table>
<thead>
<tr>
<th>Zakat Institution</th>
<th>Adjusted Working Capital Model</th>
<th>Adjusted Growth Capital Model</th>
<th>Profit and Loss Model</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lembaga Zakat Selangor</td>
<td>Current Assets – Current Liabilities = Net assets +/- adjustments</td>
<td>Owner’s equity + non current liabilities – non current assets -fixed assets – intangible assets +/- adjustments x % muslim ownership x 2.5%</td>
<td>Not stated</td>
</tr>
<tr>
<td>Pusat Pungutan Zakat, Wilayah Persekutuan</td>
<td>[Current Assets – Current Liabilities] x % muslim ownership x 2.5%</td>
<td>[Owner’s equity + non current liabilities – non current assets -fixed assets – intangible assets +/- adjustments x % muslim ownership x 2.5%</td>
<td>[Sales/ revenues/ income – expenses/ cost on sales] x 2.5%</td>
</tr>
</tbody>
</table>

Table 2: Methods of Business Zakat Accounting
The differences between Adjusted Working Capital Model and Adjusted Growth Capital Model do not result in different zakat payable. This is because the assets, liabilities and owner’s equity are derived from the Statement of Financial Position. Given the accounting equality between total assets and total liabilities and equity in the Statement of Financial Position of a business entity, zakat payable should be in the same amount.

CONCLUSION
This study revealed that different assessment methods for business zakat are necessary in order to fit with their own businesses’ characteristics. The choice of different business zakat method might be influenced by the size of the business (small or medium), sector of business (manufacturing or services) and types of business entities (sole-proprietorship, partnership or company). When business zakat is computed, the assets, liabilities and equity of the business has to be analysed in order to classify whether they are subject to zakat or not. The adjustment on certain business assets and liabilities are needed in order to arrive at accurate zakat payable amount. However, the recognition on current assets which are subject to zakat and recognition on current liabilities that are not subject to zakat is not in uniformity among the business entities (Zahri, 2014). Thus, it leads to different treatment on current assets and current liabilities that subject to zakat. Consequently, the business zakat computation will be misleading and inaccurate. It is suggested that thorough discussions among practitioners and zakat amil are conducted as to achieve a consensus in treating the current assets and current liabilities items.

The use of different methods in computing business zakat should also be adopted as to ensure zakat computed, in line with the Shariah principles and to avoid zakat gap. is accurately Business zakat sector has shown a huge potential in zakat collection especially in Public Listed Companies (Abdul Wahab & Borhan, 2016). Thus the zakat gap should be narrowed by identifying means and ways to further promote the business zakat compliance among business entities.

This study also found that the integration between zakat assessment and zakat accounting are very crucial. It is known that the financial reporting prepared by entities is meant for various users including tax authorities but not covering for zakat authorities. Therefore, the business entities should furnish additional information for zakat authorities to compute the business zakat. Previous study by Abdullah Ibrahim, Abdul Kadir, & Syed Adwam Wafa, (2012) stated that harmonization between zakat assessment and zakat accounting is highly needed.

Voluntary self-assess the business zakat is seen as a way to further increase the business zakat collection. It is almost the same with the self-assessment system implemented by individual or
business entities in assessing their individual income tax or corporate income tax. However, to promote a self-assessment system, the shareholders and management of business entities should be equipped with ample zakat knowledge. Finally, the disclosure of zakat reporting should be promoting to Muslim business entities. It gives value-added to the business entity and could enhance the transparency of the entity and produce a good governance.

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592
