

Exposure Draft

Accounting Standard

Financial Statements Disclosures of Zakat Received by an Entity

Comments to be received by February 15, 2023

The Accounting Standards Board

January 2023

CONTENTS

Accounting Standard ***Financial Statements Disclosures of Zakat Received by an Entity***

	<i>From Paragraph</i>
Objective	1
Scope	5
Disclosure	8
Effective Date	11
Basis for Conclusions (See separate table of contents)	

Objective

1. The objective of general-purpose financial reports of a not-for-profit organizations (NPOs) is to provide information about the NPO that is useful for accountability and decision making by users of the financial reports.
2. Entities in Pakistan receive and utilize zakat. The contribution and utilization of zakat also involve a large number of donors and beneficiaries.

The contributions received in the form of zakat could be material to the NPOs financial statements. Financial information about zakat is relevant and useful for the users of financial statements, including contributors and other decision-makers.
3. Financial reporting standards as applicable in Pakistan, including International Financial Reporting Standards, IFRS for Small and Medium-sized Entities, Revised Accounting Standard for Small-sized Entities, and Accounting Standard for Not-For-Profit Organizations do not provide specific disclosures regarding zakat received and utilized by an entity.
4. The objective of this Accounting Standard is to specify the disclosures of zakat received and utilized by entities to ensure sufficient, relevant, and faithful information is provided to the users of entity's financial statements.

Scope

5. The Accounting Standard shall be applied by the entities that:
 - (a) are required to prepare financial statements in accordance with the financial reporting standards as applicable in Pakistan; and
 - (b) receive zakat for utilization in its activities.
6. An entity receiving zakat shall disclose the information about zakat as per this Accounting Standard. The entity is also required to comply with all disclosures of the financial reporting standards applicable on the entity.
7. The Standard does not prescribe any requirement or parameter for modes and purposes of utilization of zakat. Further, the Accounting Standard does not specify any accounting basis for the recognition and utilization of zakat.

Disclosure

8. An entity receiving zakat shall provide following specific disclosures:
 - a) The accounting policy adopted for the utilization of zakat, stating the basis on which zakat utilized by the entity is recognized in the financial statements.

The entity shall adopt a basis for recognizing utilization of zakat, and apply it consistently. For example, the basis of recognizing zakat's utilization could be at cost of services and goods rendered, or it could be cost-plus margin basis. These are few examples and not an exhaustive list. Management is required to select the basis for utilization of zakat and disclose the same in the accounting policy.

Accounting Standard
*Financial Statements Disclosures of Zakat
Received by an Entity*

- b) The following shall be disclosed in a separate note to the financial statements:
 - i. Movement in the zakat balance during the reporting period, reconciling the opening and closing balances of zakat.
 - ii. Information about the nature and amounts of costs/expenditures for which zakat was utilized by the entity during the year.
 - iii. Closing balance of zakat and its representation by the net assets (e.g. cash and bank balances, accrued liabilities).
- 9. Entities shall consider the materiality when providing above-noted disclosures in the financial statements.
- 10. Depending on the significance of zakat received and utilized in the operations, an entity can also provide additional qualitative and quantitative disclosures in the financial statements.

Effective Date

- 11. This Accounting Standard is applicable for the financial statements prepared for the periods ending on or after June 30, 2023.

CONTENTS

Basis for Conclusions

Accounting Standard
Financial Statements Disclosures of Zakat Received by an Entity

	<i>From Paragraph</i>
Introduction	BC1
Need for this Accounting Standard	BC3
Scope of the Accounting Standard	BC15
Illustrative Disclosure	BC21

This Basis for Conclusions accompanies but is not part of the Accounting Standard, *Financial Statements Disclosures of Zakat Received by an Entity*. It summarizes the considerations of the Board when developing the Accounting Standard.

Introduction

- BC1 The Accounting Standard sets out specific disclosures regarding utilization of zakat by the not-for-profit organizations (NPOs). It responds to the need for specific disclosures on zakat utilization to ensure transparency and accountability by NPOs as financial reporting standards as applicable in Pakistan provide no specific guidance on the zakat related disclosures.
- BC2 The Basis for Conclusions explain the need and scope for this Accounting Standard. The Basis for Conclusions also contain an illustrative disclosure of zakat.

Need for this Accounting Standard

- BC3 Under the Companies Act, 2017, the financial reporting standards as applicable in Pakistan include the following:
- International Financial Reporting Standards;
 - International Financial Reporting Standard for Small and Medium-sized Entities;
 - Revised Accounting Standard for Small-sized Entities; and
 - Accounting Standard for Not-For-Profit Organizations
- BC4 The objective of general-purpose financial statements is to provide financial information about the reporting entity that is useful to a wide range of users who are not in a position to demand reports tailored to meet their particular information needs.

The general-purpose financial statements of NPOs provide information about the financial position of a reporting NPO, which is information about the NPO's economic resources and the claims against the NPO. They also provide information about the effects of transactions and other events that change a reporting NPO's economic resources and claims. They allow users to make decisions and develop expectations based on their assessment of the amount, timing and uncertainty of future net cash inflows to the NPO.

In the context of not-for-profit organizations, wide range of users of general-purpose financial statements include those to whom the not-for-profit organizations provides goods and services, providers of resources, those providing oversight functions and the public at large.

- BC5 The Board noted that zakat is a significant resource for a number not-for-organizations. The Financial reporting standards as applicable in Pakistan do not prescribe any specific disclosures related to the utilization of zakat.

Accounting Standard for Not-For-Profit Organizations

- BC6 The Accounting Standard for Not-For-Profit Organizations contains principle-based discussion regarding the 'Objectives of Preparing NPO's financial statements' and the 'Relevance of financial information'.

Paragraphs 2.6 and 2.8 of the Accounting Standard for Not-For-Profit Organizations are relevant in the context of the objectives of preparing financial statements of NPOs. These paragraphs state that:

Basis for Conclusions

Accounting Standard *Financial Statements Disclosures of Zakat Received by an Entity*

“Members, contributors, and creditors of Not-for-Profit organizations are interested, for the purpose of making resource allocation decisions, in the organization's cost of service and how that cost was funded and in predicting the ability of the organization to meet its obligations and achieve its service delivery objectives.” “Members and contributors also require information about how the management of an organization has discharged its stewardship responsibility to those that have provided resources to the organization. Information regarding discharge of stewardship responsibilities is especially important as resources are often contributed for specific purposes and management is accountable for the appropriate utilization of such resources.”

The Accounting Standard for Not-For-Profit Organizations includes the ‘Qualitative Characteristics’. Included in these characteristics is ‘Relevance’. Paragraph 2.12 explains Relevance as under: *“For the information provided in financial statements to be useful, it must be relevant to the decisions made by users. Information is relevant by its nature when it can influence the decisions of users by helping them evaluate the financial impact of past, present, or future transactions and events or confirm, or correct, previous evaluations. Relevance is achieved through the information that has predictive value or feedback value and by its timeliness.”*

- BC7 For an NPO there are two broad categories of income: income from exchange transactions (contract income) and income from non-exchange transactions (gifts).

Income from exchange transactions is received by the charity for goods or services supplied under the contract. The income the charity receives is approximately equal in value to the goods or services supplied by the charity to the purchaser. The essential feature of income from a non-exchange transaction is that the charity receives value from the donor without providing equal value in exchange

Income from non-exchange transactions (gifts) are donations of money, goods, facilities, or services that are given freely to the NPO by a donor.

- BC8 Zakat received by an NPO is a contribution. It is a non-exchange transaction/non-reciprocal transfer of assets where the donor provides zakat amount without receiving equal value in exchange.

The Accounting Standard for Not-For-Profit Organizations defines ‘contribution’ as a non-reciprocal transfer to a Not-for-Profit organization of cash or other assets or a nonreciprocal settlement or cancellation of its liabilities. Government funding provided to a Not-for-Profit organization is considered to be a contribution.”

- BC9 Under the Accounting Standard for Not-For-Profit Organizations, zakat received by an entity would be classified under ‘Contribution’.

The Accounting Standard for Not-For-Profit Organizations, however, does not specifically define or explain the accounting requirements for zakat.

- BC10 The Accounting Standard for Not-For-Profit Organizations in Section 6 *Contributions – Revenue Recognition*, contains the requirements for recognition, measurement, presentation, and disclosure of contributions, and related investment income received by NPOs.

As per Section 6 Para 6.10, NPOs have three types of contributions to report:

- endowment contributions,
- restricted contributions and
- unrestricted contributions.

- BC11 The Board noted that zakat is ordinarily classified as a ‘restricted contribution’ as it is subject to externally imposed (shariah) stipulations that specify the purpose for which it is to be used.

The Accounting Standard for Not-For-Profit Organizations defines restricted contribution as under:

“A restricted contribution is a contribution subject to externally imposed stipulations that specify the purpose for which the contributed asset is to be used. A contribution restricted for the purchase of a capital asset or a contribution of the capital asset itself is a type of restricted contribution.”

- BC12 The Accounting Standard for Not-For-Profit Organizations specifies disclosures for contributions. These are provided in section 6 of the Accounting Standard for Not-For-Profit Organizations.

The Board noted that the Accounting Standard for Not-For-Profit Organizations does not contain specific disclosures for the zakat.

IFRS Accounting Standards

- BC13 Under the IFRS Accounting Standards, IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, specifies the accounting and disclosure requirements for the government grant. IAS 20 in paragraph 39 (a) also requires to ‘disclose the accounting policy adopted for government grants, including the methods of presentation adopted in the financial statements.’

The Board noted that IAS 20 does not specify any specific disclosure of the policy under which the grants are utilized.

- BC14 The Board noted that zakat received by entities involve significant amounts. Further, a large number of donors are involved in donating zakat. The zakat utilization also involves a large number of beneficiaries.

The Board decided that the quality of financial reporting will improve by providing adequate disclosures about zakat received and utilized by an entity. The financial information about zakat provided in the financial statements will provide relevant and faithful information to the users of financial statements. The specific disclosures will ensure that consistent and comparable information is provided by the entities.

Scope of the Accounting Standard

- BC15 The Accounting Standard is intended for use by NPOs as entities receiving zakat, ordinarily, will be NPOs.
- BC16 The entities registered under section 42 or section 45 of the Companies Act, 2017, are required to prepare financial statements in accordance with the financial reporting standards as applicable in Pakistan.

Basis for Conclusions

Accounting Standard *Financial Statements Disclosures of Zakat Received by an Entity*

The financial reporting standards as applicable in Pakistan for such entities include:

- International Financial Reporting Standards; or
- International Financial Reporting Standard for SMEs; and
- Accounting Standard for Not-For-Profit Organizations

- BC17 The Accounting Standard, *Financial Statements Disclosures of Zakat Received by an Entity*, shall be applied by the entities that receive zakat, and such entities under the Companies Act, 2017, are required to prepare financial statements in accordance with the financial reporting standards as applicable in Pakistan.
- BC18 When applying the disclosure requirements related to zakat an entity would also be applying all other requirements of financial reporting standards as applicable in Pakistan.
- BC19 The Accounting Standard can also be used by non-profit organizations that are not registered under section 42 or section 45 of the Companies Act, 2017.
- BC20 The Board clarified that it has not prescribed any framework / criteria for evaluation of the shariah compliance relating to zakat, including computation and utilization of zakat. Compliance with shariah principles is the responsibility of the parties to the transaction/arrangement.

Illustrative Disclosure

- BC21 An illustrative disclosure of the requirements of paragraph 6(b) of Accounting Standard is provided for guidance purposes only.

	20X2 (Rs.)	20X1 (Rs.)
Zakat available for utilization		
Opening balance of zakat	xxx	xxx
Zakat received during the year	xxx	xxx
	<u>xxx</u>	<u>xxx</u>
Zakat utilized during the year		
Zakat utilized on providing goods and services to the beneficiaries	xxx	xxx
Zakat utilized for general and administrative and general expenses of entity	xxx	xxx
Zakat utilized for other (mention the nature of activity/expenditure)	xxx	xxx
	<u>xxx</u>	<u>xxx</u>
Closing balance of the zakat	<u>xxx</u>	<u>xxx</u>
Closing balance of the zakat is represented by:		
Cash and bank balances related to zakat balances	xxx	xxx
Less: zakat related accrued expenditures	xxx	xxx
	<u>xxx</u>	<u>xxx</u>