

# EXPLORING THE MOTIVATIONAL FACTORS FOR CORPORATE ZAKAT PAYMENTS

SHERIFF MUHAMMAD IBRAHIM<sup>1</sup>

Universiti Sains Islam Malaysia (USIM), Bandar Baru Nilai, Negeri Sembilan, Malaysia

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**Abstract:** This paper intends to explore the motivating factors of corporate zakat payment in line with the prescribed Islamic laws, it aims to check if zakat is paid based on conviction and commitments by the corporate organization or paid as tax that could be evaded when there are lapses in management. The paper reviews the concept of zakat according some selected financial institutions saddled with accounting and auditing of zakat funds, to study their perceptions of zakat and its obligation in respect to corporate payments. The methodological approach of the paper is mainly qualitative, sourcing it data from the previous literature conducted on the topic. The discussion on the analysis of the research findings indicates that there are misinterpretations of zakat leading to misconceptions and in appropriate perceptions as to whether zakat paid is to be as expense or dividend in the organizational balance sheets and income statements. The paper reveals that zakat payment is motivated by total submission to Allah's command, motivated by earning his pleasures and avoiding his anger, zakat is also paid to benefit from spiritual and material growth and increase in wealth. The paper also presents tax rebate as a motivating tool used to facilitate corporate zakat payments.

**Keywords:** motivating, corporate, zakat, payments.

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## I. INTRODUCTION

*Zakat* is alms imposed on Muslims by Allah upon acquiring a minimum amount of wealth called *Nisab*, which is to be given to a specific category of people called *Asnaf*. *Zakat* is the third of the five major pillars of Islam and it is a divine act imposed by Allah on the rich Muslim, which is to be carried out through their legitimate earnings to the less privileged. From the perspective of *Fiqh*, *Zakat* is a specific amount of explicit properties made compulsory by Allah to be distributed among the people called *Asnaf* (Qardawi, 2006). Classical jurists considered the traditional sources of *zakat* i.e. *Quran* and *Sunnah* to conform that there is no *zakat* imposed on any property, unless it reaches the *nisab*, laid by *shariah*. The limit of *nisab* was institutionalized by the Prophet S.A.W. The Prophet determined *nisab* for *zakatability* as follows: five camels and above; forty sheep and beyond 200, 2.5% for silver *dirhams* and five *wasq* (653 kilograms) for grain. Khan (2003) further relates that *nisab* of 2.5% is imposed on the business capital, 10% or 5% from the farm produce and 20% of the found treasures. Abu Saud (1988) quoted Ibn Taymiah's support for the rationale behind the differences in the rate. He believed that the effort required for diverse wealth types differ according to their nature, and as a result, the *nisab* must vary.

In the early period, zakat is only seen as religious obligation that is mandated on every rich Muslim. There was no distinction between the funds collected of zakat as to whether it is considered an expense of the owner of dividend, but it is clear that zakat payers used to be happy when they pay zakat as they believe to have carried out a religious obligation and expecting it reward by Allah, this means they assume zakat paid as dividend of their wealth. There are also reported instances when people denounces the payments of zakat which led to forced collection and punishment, for these category of people, zakat might have seen as expenditure or even liability.

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<sup>1</sup> Corresponding author, He can be contacted at [cairomjd@yahoo.co.uk](mailto:cairomjd@yahoo.co.uk)

In recent days, zakat is considered is a positive tool for poverty reduction and establishment of social welfare (Sheriff and Amir 2013), many Muslim communities have adopted the zakat methods into a corporate public responsibility and overseen or monitored by government agencies. Countries like Malaysia, Sudan and Indonesia for example ensure to have a remarkable output from zakat wealth, by broadening the institutions of zakat and ensuring that zakat is paid by both individuals and companies (Sheriff 2015).

Considering the fact that zakat is believed as an act of worship stipulated by Islam with unique guidelines, it becomes imperative for zakat organizations to establish a standard accounting and computation systems to help in fulfilling the zakat obligation.

This study therefore, aims to check the accounting standards sets by the zakat governing bodies with special reference to the Accounting and Audition Organization of Islamic Financial (AAOIFI) and Malaysian Accounting Standard Board (MASB). With objective of correcting the notion that zakat is collected as expenses from the corporate and individuals accounts not as dividend. This misconception affects the values of zakat as a religious obligation aiming at establishing social welfare among Muslim communities. It also contradicts the Islamic concepts of ownership which states that Allah is the ultimate and supreme owner of all wealth and assets, this is in opposite to conventional perspectives of ownership which states that all properties belongs to their direct owners.

These misinterpretations resulted to mistreatments and mishandling of zakat obligations, to some extent that some organizations see zakat as a burden rather than relief from an obligation, leading to evasion of zakat taxes or underpayments and miscalculation of zakat rights (Adnan & Nur Bazirah 2009). Miscalculation and inappropriate accounting is believed to lead to unfavorable practices and in turn will negatively affect people's behavior (Godfrey *et al.*, 2006). In order to avoid a situation where corporate bodies will find a way to zakat evasion and changing its concepts from spiritually motivated obligation to conventional enforced tax payments, this paper reviews the implications of treating the assessment of zakat funds as expenses in the balance sheets of corporate organization.

This paper is organized to discuss the early methods of zakat accounting and assessments, the contemporary concepts of zakat assessments, assessment of zakat on corporate organization, accounting standard for zakat in corporate organization and accounting treatments of zakat in corporate organization. The paper also discusses the tax rebate as a source of motivation in corporate zakat payments.

## **II. THE EARLY PERIOD**

The Prophet himself carried out *Zakat* collection and distribution, and sometimes he assigns some of His companions to carry out the duty of collection and distribution of *Zakat*. This shows that the system of *Zakat* collection and distribution is dynamic. Thereafter, Uthman bn Affan (R.A) attempted to lighten the burdens of *Zakat* collection and distribution by asking the *Zakat* payers to give the dues to the eligible recipients of *Zakat*. Similarly, the Ummayad dynasty (40-60H) also adopted the early system of *Zakat* collection by appointing a staff charged with the responsibility of collection and distribution of *Zakat*. This system was restricted to livestock and agriculture in the Ummayad dynasty (Ibn Kathir 1997). Patmawati (2005) reported that no data could be traced on the amount collected and distributed in the classical Islamic era. However, there were reports that gave the degree of success recorded by *zakat* systems during the time of Umar Ibn AlKhattab (13-22H), and Umar Ibn Abdul Azeez (99-101H). This was detected through the elimination of poverty in the early Muslim communities (Sadeq 2004).

The history of *Zakat* administration began with the legislation of the institution of *Zakat*. The prophet (SAW) had assigned the duty of collecting and distributing of *Zakat* to some of his companions. He sent them to various locales after giving them the instructions on how to carry out the task. For instance, when the prophet (SAW) sent Mu'adh bn Jabal to another community, he instructed him as follows;

*"You will go to people of the Scripture (i.e., the Jews and the Christians). First of all invite them to testify that here is no true god except Allah and that Muhammad (PBUH) is His slave and Messenger; and if they accept this, then tell them that Allah has enjoined upon them five Salat (prayers) during the day and night; and if they accept it, then tell them that Allah has made the payment of Zakat obligatory upon them. It should be collected from their rich and distributed among their poor; and if they agree to it, don't take (as a share of Zakat) the best of their properties. Beware of the supplications of the oppressed, for there is no barrier between it and Allah"* [Bukhari].

It has been the practice of the prophet, his companions and their followers to assign the trustworthy ones among the Muslim community to collect and distribute *Zakat*, while the responsibility of accounting and auditing of *Zakat* funds rests on the Muslim leader. The prophet (SAW) have audited and accounted *Zakat* collectors and distributors. *Imam* Muslim reported;

*“The Messenger of Allah, peace and blessings of Allah be upon him, appointed a man named Ibn al-Lutbiyyah among the tribe of Banu Asad to collect zakat from the Banu Sulaim, so when he returned, the prophet called him to account for it”*

This tradition emphasizes that *Zakat* funds are normally collected and distributed by leaders or authority of the Muslim community. Ibn Hajar (1986) in his explanation of the hadith reported by Muadh says that when the prophet (SAW) sent Mu'adh to Yemen, he was given the authority and responsibility for *zakat* collection and distribution. Therefore, leaders may wish to collect *Zakat* themselves or assign the duty to the capable hands. In a situation where a person refuses to pay *Zakat*, the leaders should collect it from such a person forcefully.

Patmawati, (2005) stated, that during the life time of the Prophet, the *zakat* collection and distribution exercises was not recorded. This is due to the fact that the prophet (SAW) distributed the *Zakat* revenue himself, and sometimes authorized *Zakat* collectors to distribute the *Zakat* revenue to the entitled people at the time of collection. Umar Ibn al-Khattab initiated another method of collecting *Zakat* during his time, by setting checkpoints at the gates of the Muslim towns to collect *Zakat* from the traders and to collect tax from the non-Muslims. Umar also introduced a treasury for *zakat* and *waqf* revenues, named *Baytulmal* in 15 A.H (Farah et al. 2012).

The early Muslim generations believed that through the adaption of *zakat*, the sincerity of a Muslim's faith towards his God is understood. By giving out *zakat* the righteousness and the level of piety increases (Fuadah et. al 2013). *Zakat* is also referred to *sadaqah*, derived from the word *sidq*, which means truth. Hence, the truthfulness of the *zakat* giver can be assessed by proper calculation of his assets in order to observe religious duty by giving it to the poor (Abdullah and Abdulquddos 2013).

This commitment makes it easier for people living during the lifetime of the Prophet to familiar with *zakat* and able to account it without resorting to discussion its accounting stands, it does not matter to them if it's an expense or a dividend. However their commitments to *zakat* indicate that they view it as more of dividend that expenses.

In the early Muslim epochs, the *zakat* collection was carried by the state as a tax imposed by *shariah* and distributed among the needy (Marshal 1985). *Zakat* as an Islamic welfare system, was not only seen as a mere spiritual charity, but was enforced on the power and autonomy of the state so as to affirm the sustainability and the wellbeing of the community through redistributing wealth.

### III. THE CONTEMPORARY PERIOD

Lately, Muslim scholars have shown serious concern over the change in the concept of wealth as it differs drastically from the traditional concept. They have been debating on the possibility of *ijtihad* over the newly emerging *fiqhi* issues related to *zakat* collection and distribution (Haneef and Mahmud 2011).

Other scholars concluded that inability of the *zakat* funds to serve as an effective fiscal tool against poverty is mainly due to the inefficient *zakat* collection and distribution (Chapra 1992). Among the major indications of fewer *zakat* funds observed by the scholars is the issue of narrowing interpretation of the *zakat* and its principles. This leads to limiting the chances of application of *ijtihad* to enhance the methods of *zakat*.

In the recent times, *zakat* is perceived beyond the context of religion, rather it is seen as a practice that helps in redistribution of wealth and ensures social welfare. This draws *zakat* institutions to the field of academics, attracting many researchers. The *zakat* system is usually considered by researchers as a solution for many social and economic hitches.

The expansion of research in the area of *zakat* influenced the emergence of practical elucidations of *zakat*, enhancing the *zakat* institution towards accommodating contemporary changes in line with the Islamic provisions (Adnan and Nur Bazirah 2009).

Among the recent definitions of *zakat*, Accounting and Auditing Organization of Islamic Financial institutions (AAOIFI, 2001) came up with this description, “*Zakat* means “blessing, purification, increase and cultivation of good deeds. In *Shariah*, it is an obligation in respect of funds paid for a specific type of purpose, and for specified categories, government may authorize shareholders to pay it personally if it is guaranteed that they will do so; it may instruct the Islamic banks to organize its payment on behalf of their shareholders, using the basis for *nisab* as described” (AAOIFI, 2001).

Another definition of *zakat* is given by the Malaysian Accounting Standard Board (MASB 2006) as follows:

“*Zakat* is an obligatory contribution assessed based on certain assets owned by a Muslim, satisfying certain conditions and is to be distributed to the specified category of beneficiaries.” While *zakat* on business is defined as an “obligatory contribution assessed based on the business assets owned by an entity, which satisfies certain conditions and is to be distributed to the specified categories of beneficiaries.”

There are common differences in the definitions above that will be discussed later in the study.

#### **Assessment of *Zakat* on Corporate Organization:**

Scholars have agreed on the application of *zakat* related to the corporate organizations as discussed in the previous section. Yet, there are many views regarding the accountability of *zakat* on corporate organizations. Discussion on corporate *zakat* is significant in this study in trying to suggest the best model for the accountability of *zakat* for these organizations.

*Zakat* is acknowledged as an important mechanism in eradicating poverty that is one of the most prevalent social problems in the world. Hence, the duty of giving *zakat* should not be limited to individuals; rather it should be extended to corporate entities. It could be noticed that the above discussion on *nisab* is centered towards individual *zakat* collection, and does not cover the aspect of groups of people sharing the same source of funds. This section will discuss the accounting standards related to corporate assessment of *Zakat*, and the accounting treatments for corporate *zakat*.

There are few literatures covering the aspect of accounting treatments for *zakat* in relation to the corporate bodies. However, some scholars have tried to identify the relationship between accounting and *zakat*. These scholars include: Al-Moghawli (2001), al-Habshi (2005), Sulaiman (2003), Mursyidi (2003), Khan (2003), Islahi and Obaidullah (2004), Bahari and Hanat (2004). It is very fortunate that despite the limited resources on the corporate *zakat*, yet a few accounting regulatory bodies took a very commendable step by trying to develop accounting standard and treatments for corporate bodies. These bodies include Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI), the Malaysian Accounting Standard Board (MASB) and the Indonesian Institute of Accountants (IIA).

#### **Accounting Standards for Corporate *Zakat*:**

Accounting standards refer to accounting guidelines developed to deal with specific financial accounting and reporting issues (Adnan, 2009). *Zakat* as financial institution requires to have established accounting standards guidelines governing the *Zakat* of corporate organization. These guidelines were developed by these limited organizations mentioned above.

AAOIFI is an organization established for the purpose to handle the activities of the Islamic financial institutions and to issue fatwas regarding financial matters arising at the Islamic financial institutions. The AAOIFI has issued Financial Accounting Standard (FAS) NO. 9; this financial code specifically governs the accounting treatments for *Zakat* in corporate bodies especially banking and financial institutions. It was adopted by the AAOIFI board members in June 1998, and was put into practice on the 1st Muharram 1420, or 1st January 1999.

In Malaysia, the Malaysian Accounting Standard Board MASB (2006), which is an institution taking charge of all accounting activities related to *Zakat*, issued a Technical Release i-1 (TR i-1) “Accounting for *Zakat* on Business”. TR-i1 became effective on the 1st July, 2006. However, TR-i1 maintained that it has limited jurisdiction towards *zakat* collection, distribution, calculation and determination. It admits that it only deals with financial reporting issues related to a corporation’s *zakat*.

Similar steps were taking by the Indonesian Institute for Accountants IIA. This organization is mainly designed to accommodate the scores of *zakat* institution in the country, including public and private *zakat* organizations. This is for designing the accounting standard for *zakat* as asserted regarding the *Ulama* Indonesian Council. The *zakat* payers are individuals and not companies, meaning that companies or corporate bodies are not obliged to pay *Zakat* (Aru, 2007).

#### **Accounting Treatments for Corporate *Zakat*:**

Accounting standards are formulated to deal with basic issues related to *Zakat*. These may include definition, recognition, measurement, presentation and disclosure.

Recall, that we have earlier mentioned that AAOIFI defined *zakat* in its release called (FAS) No.9 as,

“Blessing, purification, increment, and cultivation of good deeds, in *shariah*, 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 of its payment on behalf of Islamic banks shareholders, using combined basis of *nisab*" AAOIFI, 2001.

AAOIFI made it clear that there are two possible scenarios regarding the treatment of *zakat*; one is the case that an Islamic bank is obliged to pay on behalf of the shareholders; and the other holder paying *zakat* on his own. AAOIFI (2001) also mentioned these situations in which Islamic banks could be charged with the responsibilities of *zakat* payment on behalf of the shareholders; (a) when the law imposes Islamic banks to pay *Zakat*; (b) when the charter or laws of the bank requires paying *zakat*; (c) and when the shareholders approves the resolution of approving *zakat* payments.

MASB defines *zakat* as, "obligatory contribution assessed based on certain assets owned by a Muslim that satisfies certain conditions and is to be distributed among specific 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 specific categories".

It is clear that the definitions presented by AAOIFI are more consistent with the spiritual objectives of *zakat*, than the interpretations done by MASB. This may be connected to the fact that AAOIFI is basically established to guide the operations of Islamic financial institutions, while MASB focused on general accounting standards for business and monetary transactions. However, both AAOIFI and MASB recognize that *zakat* is treated as a non-operational expense to appear in the organizational net income statements. In line with the view that organizational properties belong to the owners of proprietors of the organization.

The perception of treating *zakat* funds as an expense contradicts the principles of ownership in Islam. The Islamic concept of ownership insists that Allah is the supreme and ultimate owner of all what is in the universe and earth, human beings are not more than trustees to all properties entrusted to them by Allah.

Alghazali (1983) maintained that human beings are only proprietors to the properties entrusted to them by Allah and they should be ready to spend Allah's trust according to his wish. Thus, through the adaption of *zakat*, the sincerity of a Muslim's faith towards his God is understood. By giving out *zakat* the righteousness and the level of piety increases (Fuadah et. al 2013). *Zakat* is also referred to *sadaqah*, derived from the word *sidq*, which means truth. Hence, the truthfulness of the *zakat* giver can be assessed by proper calculation of his assets in order to observe religious duty by giving it to the poor (Abdullah and Abdulquddos 2013).

It is also argued that the concept of growth in the definition of *zakat* is not limited to spiritual growth of wealth and piety but covers psychological and material growth (Abubakar 2008). A study conducted by Zaim (Sadeq 2004) indicates that *zakat* has the potentials of physical multiplying of wealth and able to eliminate poverty. *Zakat* provides employments opportunities which will help in raising the income aggregate, the results of *zakat* payments could be seen in increasing the standard of living and stabilization of income inequalities among the communities.

Recall, *zakat* is a compulsory duty in Islam and its physical impacts could be seen, by the *zakat* givers, by making the *zakat* payment compulsory and socially positive mechanism in establishing social welfare, *zakat* givers could be divided into two categories; (a) *zakat* givers that gives *zakat* based on personal conviction, free will and obedience to Allah the creator, hoping to attain his pleasure and increase their wealth, (b) the person that pays *zakat* to as an obligation to avoid Allah's anger and punishments. This classification makes it clear that while the former pays *zakat* as dividend the later pays it as obligation which may be attributed to expenses. Islam is does not recognize any good deed done without total submission and willingness (Alghazali 1983)

An expense in the conventional accounting perspective has many definitions few amongst are; (1) money spent by a firm to help in continuing its ongoing operations (2) money that is spent on any cost that is incurred which are deductible and reduce tax income, (3) the decrease in economic in economic benefit over the period of accounting that happens in forms of outflow, depletion of assets or incurrences of liabilities are all referred to as expense.

Rationally, it is very difficult to determine any relationship between the above definition of expense and the Islamic principles governing the *zakat* payments. *Zakat* payments does not aim at continuing any ongoing business or projects neither its meant to cover any ongoing capital expenditure. It does not also fit to be considered as capital payment deductible from an income as *zakat* funds. *Zakat* is rather collected even when the business incurred loss as long as the remaining balance reaches the *nisab*. It is also paid from capital properties such as machineries and other properties used for the production.



Generally, zakat is an act of worship aiming at the transfer of wealth from a trustee who is human being to its legitimate owner who is Allah, zakat therefore cannot be classified as expense.

#### **Corporate Zakat Payment and Tax deduction Methods: The Malaysian Model:**

Corporate Zakat Payment and Tax deduction Methods: the Malaysian Model Zakat on business income paid by the Labuan offshore companies has been given as an Income tax rebate. This rebate is equivalent to the amount of business zakat paid to the religious authorities. It is subjected to a maximum of 3% of net profit or RM 20, 000, which is effective from the assessment year of 2004. This practice is however not applicable for zakat on business income paid by other companies until assessment year of 2005. Hence, zakat paid by the companies is allowed as a deduction, subjected to a maximum of 2.5% of the aggregate Income, excluding zakat paid by cooperatives and trust bodies. In order to accord equal tax treatment between companies and trust bodies, zakat settled by cooperatives and trust bodies is also allowed as a tax deduction. It is effective from the year of assessment 2007. This is to be approved via section 44(1TA) of the Income Tax Act 1967 (Hamat 2009).

From the above discussion, it is obvious that the data used for business zakat accounting method and business tax deduction is different. Business zakat accounting uses the data from the balance sheet - a balance sheet is a snapshot of a business' financial condition at a specific moment in time, usually at the conclusion of an accounting period. A balance sheet comprises assets, liabilities, and owners' or stockholders' equity - while business tax deduction gains information from the income statement (An income statement, also known as a profit and loss statement, is a summary of a company's profit or loss during any given period of time).

The income statement records all revenues for a business during this given period, as well as the operating expenses for the business). In other words, this demonstrates no relationship between business zakat accounting method and tax on business income due to the different sources of information. The question that arises is, if the business zakat accounting depends on these methods, does entrepreneur get benefits from the allowed tax deduction. Principally, zakat is payable on the business irrespective of whether profit has been earned or unearned, as far as the business has a positive working capital, it is zakatable.

The entrepreneurs would not utilize their benefits in two situations; the first situation is when their business suffers a loss but still has a positive working capital; and the second situation is when tax deduction is smaller than the amount of business zakat paid. In this case, what modification or adjustment should be done? It actually requires synchronization between *fiqh* and law, which is currently practiced in Malaysia.

According to the Mufti of the Selangor State Government, Islamic scholars must be introduced to new interpretations and changes of the hokum made, which were formulated by earlier scholars, especially in matters related to zakat. In fact, any changes to the section 44(ITA) of the Income Tax Act 1967 requires many deliberations (Hamat 2009).

#### **IV. RECOMMENDATION AND CONCLUSION**

This study established that the contemporary definitions of zakat presented by the coordinating institutions is not in tandem with the spiritual objectives of zakat, the definition should be revisited to present zakat as dividend instead of expense. Zakat is presented in this study as a religious charity that is motivated by self-desire to obey the Creator and earn rewards, avoid His punishments, and earn spiritual and physical growth and increase in his wealth.

Tax rebate for corporate institutions will also play a significant part in ensuring zakat payments; the willingness to cooperate with zakat payments will be higher when a company feels relieved from the burden of multiple taxations by both the zakat institution and conventional taxes.

The paper also recommends disclosure methods presented by AAOIFI for corporate institutions; it is believed that when the adequate system is established the facilitation for the zakat payment will be strengthened. AAOIFI it forward eight rules governing the disclosure as follows;

- a- Method used for determining the zakat- base and the items included in the base.
- b- The ruling of the *Shariah* Supervisory board of the Islamic bank on issues related to zakat that are not included in the standard
- c- Whether or not the Islamic bank has a holding company pays its share of zakat obligations in its subsidiaries

- d- The amount of *zakat* due from the equity investment account holders.
- e- Whether or not the Islamic bank collects *zakat* on behalf of holders of investment accounts and other accounts.
- f- The restrictions imposed by *Shariah* Supervisory board of the Islamic bank in determining the *zakat* base.
- g- The need to observe the FAS No 1: general Presentation and Disclosure In Financial Statements of Islamic bank and Financial Institutions (MASB 2004).

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