

# ACCOUNTING FOR ZAKAH FUNDS: A NOTE

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## OBJECTIVE

The purpose of this note is to explain how a not-for-profit organization (NPO) which collects and distributes *zakah* as part of a range of socially beneficial activities should practice transparent accounting methods to ensure compliance with the *Shariah* stipulation regarding the beneficiaries. The holy Quran [9:60] clearly specifies the types of beneficiaries who are entitled to receive *zakah*.

﴿ إِنَّمَا الصَّدَقَتُ لِلْفُقَرَاءِ وَالْمَسْكِينِ وَالْعَمِلِينَ عَلَيْهَا  
وَالْمُؤَلَّفَةِ فُلُوقِهِمْ وَفِي الرِّقَابِ وَالْغَرَمِينَ وَفِي سَبِيلِ اللَّهِ  
وَأَبْنِ السَّبِيلِ فَرِيضَةً مِّنَ اللَّهِ وَاللَّهُ عَلِيمٌ حَكِيمٌ ﴾

These are:

1. The poor
2. The needy
3. Those in debt
4. Employees of *zakah* organization
5. Those in bondage
6. The travelers
7. Those whose hearts are reconciled towards the truth
8. Those striving in the path of Allah SWT

An important precondition for an NPO to efficiently collect and distribute *zakah* funds is its credibility in the society. This in turn, is directly related to the transparency of its accounting methods that ensure separation of *zakah* from other sources of funds, such as, *sadaqah* (donations free from restrictions regarding intended beneficiary), *qard* (interest free loans), cash *waqf* (endowment), for-profit investments, etc. *Zakah* being in the nature of worship (*ibadah*), any perceived inability or unwillingness on the part of the NPO to maintain a wall of

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separation between *zakah* and other mechanisms of socially beneficial activities may seriously hamper its *zakah* mobilization efforts.

### A HYPOTHETICAL EXAMPLE

Below we use a hypothetical example of a sample of financial transactions by an NPO to highlight how the NPO may address the above concern of *zakah* payers through appropriate accounting methods. We present two scenarios to demonstrate the differential accounting treatment of *zakah* between an accounting system that is compliant with the above *Shariah* stipulation and one that is not. To simplify the example, we assume that in both cases, *zakah* and *sadaqah* are the only two sources of funds for the NPO and it uses the funds for running a school and a hospital. We also assume that the NPO commences operations with a zero base.

The following financial transactions take place during a time period X.

1. A donates 50,000 INR to the NPO as *zakah*
2. C donates 250,000 INR to the NPO as *zakah* and 50,000 INR as *sadaqah*
3. Payment of salary of 60,000 INR to school teachers by school
4. The hospital pays INR 400,000 towards purchase of medical equipment on credit
5. The NPO pays 35,000 INR for salary of all its staff (hospital staff: 25,000 INR, *zakah* officers: 10,000)
6. The school pays 5,000 INR for purchase of consumables
7. The hospital pays 60,000 INR as fees to doctors
8. The NPO pays 50,000 INR for rent for building which houses the school and hospital
9. B donates 150,000 INR to the NPO as *sadaqah*
10. School collects fee of 50,000 INR from students
11. Hospital collects fee of 150,000 INR from patients
12. The NPO has outstanding fees of 12 poor students amounting to 24,000 INR, 50% of which may have to be written off
13. The NPO has outstanding dues from 10 patients who are unable to pay amounting to 15,000 INR, 10% of which may have to be written off
14. The hospital makes payment of 250,000 to supplier of equipment
15. The NPO undertakes a promotional campaign for mobilization of donations at a cost of 55,000 INR; payment to be made after two months.

## SCENARIO ONE

The NPO makes the following entries in its journal corresponding to the above transactions.

No.	Account	Dr.	Cr.
1.	Cash	50000	
	Donations		50000
2.	Cash	300000	
	Donations		300000
3.	Salaries	60000	
	Cash		60000
4.	Equipment	400000	
	Accounts Payable		400000
5.	Salaries	35000	
	Cash		35000
6.	Consumables	5000	
	Cash		5000
7.	Consulting Charge	60000	
	Cash		60000
8.	Rent	50000	
	Cash		50000
9.	Cash	150000	
	Donations		150000
10.	Cash	50000	
	School Fee		50000
11.	Cash	150000	
	Hospital Fee		150000
12.	Fee Receivable	24000	
	School Fee		24000
12.	Provision for Doubtful Debt	12000	
	Fee Receivable		12000
13.	Fee Receivable	15000	
	Hospital Fee		15000
13.	Provision for Doubtful Debt	1500	
	Fee Receivable		1500
14.	Accounts Payable	250000	
	Cash		250000
15.	Advertising and Promotion	55000	
	Accounts Payable		55000

The ledger would have the following T-Accounts.

<b>CASH</b>	
1. 50000	3. 60000
2. 300000	5. 35000
9. 150000	6. 5000
10. 50000	7. 60000
11. 150000	8. 50000
	14. 250000
700000	460000
Bal. 240000	

<b>DONATIONS</b>	
	1. 50000
	2. 300000
	3. 150000
	500000

<b>EQUIPMENT</b>	
4. 400000	

<b>SALARIES</b>	
3. 60000	
5. 35000	
95000	

<b>CONSUMABLES</b>	
6. 5000	

<b>CONSULTING CHARGE</b>	
7. 60000	

<b>RENT</b>	
8. 50000	

<b>SCHOOL FEE</b>	
	10. 50000
	12. 24000
	74000

<b>HOSPITAL FEE</b>	
	11. 150000
	13. 15000
	165000

<b>FEE RECEIVABLE</b>	
12. 24000	12. 12000
13. 15000	13. 1500
39000	13500
Bal. 25500	

<b>PROVISION FOR DOUBTFUL DEBT</b>	
12. 12000	
13. 1500	
13500	

<b>ACCOUNTS PAYABLE</b>	
14. 250000	4. 400000
	15. 55000
250000	455000
	Bal. 205000

<b>PROMOTION</b>	
15. 55000	

Now we may prepare the **Balance Sheet** and **Income Statement** of our NPO.

**Balance Sheet** of NPO as on time  $T_n$

Assets		Liabilities	
Cash	240000	Account payable	205000
Equipment	400000	Corpus (donation) fund	500000
Consumables	5000	Loss transferred to Corpus	(21000)
Fee receivable	25500		
Provision for doubtful debt	13500		
<b>Total assets/liabilities</b>	<b>684000</b>		<b>684000</b>

Income Statement of NPO for period  $T_0$ - $T_n$

Hospital fee		165000
School fee		74000
<b>Total Revenue</b>		<b>239000</b>
Rent	50000	
Promotion	55000	
Salaries	95000	
Consulting charge	60000	
<b>Total Expenses</b>	<b>260000</b>	
<b>Net profit (loss)</b>		<b>(21000)</b>

## OBSERVATIONS

The accounting system in this case does not reveal how the *zakah* funds have been utilized due to its commingling with sadaqa funds. The beneficiaries of the school and hospital include extremely poor, moderately poor and rich and all are charged for the services at a price that may indeed include a subsidy element financed from donations. The above example shows a loss of 21000 INR absorbed by the corpus fund. Thus, though the NPO may have provided a socially desirable service at a low cost, there is no discrimination in favor of the poor, which the *Shariah* envisages through the institution of *zakah*. It is a possible scenario that the NPO goes on to write-off the receivables due from the poor. But this benevolence is not captured by its accounting system. We now turn to Scenario II as an alternative system of accounting.

## SCENARIO TWO

In this scenario, the NPO now creates a *Zakah* Fund under its umbrella managed by a distinct Zakat Unit. This Unit keeps track of funds mobilized as *zakah*, maintains separate records of its own administrative and other expenses and issues tickets to the poor and needy after investigating their financial condition that entitles them to avail waivers in school fees and hospital charges. The transactions, journal entries and ledger now undergo some minor modifications, but have significant consequences in terms of improved transparency as follows:

1. A donates 50,000 INR to the NPO as *zakah*
2. C donates 250,000 INR to the NPO as *zakah* and 50,000 INR as *sadaqah*
5. The NPO pays 35,000 INR for salary of all staff (hospital staff: 25,000 INR, *zakah* officers: 10,000)
9. B donates 150,000 INR to the NPO as *sadaqah*
12. The NPO has outstanding fees of 12 poor students amounting to 24,000 INR, 50% of which may have to be written off (*the poor students collect a fee waiver ticket from the zakah office*)
13. The NPO has outstanding dues from 10 patients who are unable to pay amounting to 15,000 INR, 10% of which may have to be written off (*the poor patients collect fee waiver ticket from the zakah office*)

No.	Account	Dr.	Cr.
1.	Cash	50000	
	<i>Zakah</i> fund		50000
2.	Cash	300000	
	<i>Zakah</i> fund		250000
	Corpus ( <i>sadaqah</i> ) fund		50000
5.	Salaries (ZU)	10000	
	Salaries	25000	
	Cash		35000
9.	Cash	150000	
	Corpus ( <i>sadaqah</i> ) fund		150000
12.	<i>Zakah</i> disbursement	24000	
	School Fee		24000
13.	<i>Zakah</i> disbursement	15000	
	Hospital Fee		15000

<b>ZAKAH FUND</b>	
	1. 50000
	2. 250000
	300000

<b>CORPUS (SADAQAH) FUND</b>	
	2. 50000
	9. 150000
	200000

<b>SALARIES</b>	
3. 60000	
5. 25000	
85000	

<b>ZAKAH DISBURSEMENT</b>	
12. 24000	
13. 15000	
39000	

<b>SALARIES (ZU)</b>	
5. 10000	

Now we may prepare the **Income Statement** and the **Balance Sheet** of the NPO.

**Balance Sheet** of NPO as on time  $T_n$

<b>Assets</b>		<b>Liabilities</b>	
<b>Cash</b>	240000	Account payable	205000
<b>Equipment</b>	400000	Corpus (donation) fund	200000
<b>Consumables</b>	5000	Loss transferred to Corpus	(11000)
		<b>Zakah surplus</b>	<b>251000</b>
<b>Total assets/liabilities</b>	<b>645000</b>		<b>645000</b>

### Income Statement of NPO for period $T_0$ - $T_n$

Hospital fee		165000
School fee		74000
<b>Total Revenue</b>		<b>239000</b>
Rent	50000	
Promotion	55000	
Salaries	85000	
Consulting charge	60000	
<b>Total Expenses</b>		<b>250000</b>
<b>Net profit (loss)</b>		<b>(11000)</b>

### Statement of *zakah* collection and disbursement for period $T_0$ - $T_n$

<b>Zakah funds collected</b>		<b>300000</b>
Zakah disbursement	39000	
Salaries ( <i>zakah</i> unit)	10000	
<b>Total Expenses</b>		<b>49000</b>
<b>Zakah surplus</b>		<b>251000</b>

### OBSERVATIONS

It is now clear from the Statement of *zakah* collection and disbursement that the NPO is holding a huge *zakah* surplus, which remains to be utilized. This is not proper according to rules of *zakah* and cannot be justified based on ground realities, given that the poor deserve massive support for their education and health needs. This indeed calls for proactive action and sharing of information by the NPO to attract the poor so that they may benefit from its *zakah*-financed activities. On the contrary, there seems to be a strong motivation for the NPO not to do so. It would perhaps be more inclined to see the accumulation of *zakah* surplus as a justification for investment of such surplus in for-profit avenues, especially when it reports an overall financial loss. However, this would amount to a mission-drift, which may prove disastrous for the long-term sustainability of the NPO.