ZAKAT

هيئة الزكاة والضريبة والجمارك
Zakat, Tax and Customs Authority

Guideline

Manual of Transition to the International Financial Reporting Standards

and its impact on Calculating Zakat for Taxpayers Obligated to Maintain Statutory Accounts in the Kingdom of Saudi Arabia

IAS No. 2 "Inventories", IAS No. 16 "Real estate, plant and equipment", and IFRS 13 "Fair Value Measurement"

Version One November 1 2021

This Manual is indicative and constitutes the concept and interpretation of the Zakat, Tax and Customs Authority (ZATCA) with regard to the implementation of the Executive Regulations of Levying Zakat promulgated by the Ministerial Resolution No. (2216) dated 07 Rajab 1440 AH. It is not a statutory document, and its provisions are indicative, non - binding to ZATCA, and it does not eliminate the need to peruse the Executive Regulations for Levying Zakat and the relevant rules and resolutions.

This Manual is indicative, and includes a summary of the most important considerations with respect to application of International Financial Reporting Standards (IFRSs) approved in the Kingdom of Saudi Arabia. It is not a statutory document. The provisions thereof are guiding, and it does not eliminate the need to peruse to the International Financial Reporting Standards approved in the Kingdom of Saudi Arabia and other standards and publications approved by the Saudi Organization for Chartered and Professional Accountants. All diagrams and drawings contained herein are for illustrative purposes and may not include all requirements and exceptions to the standards. The Authority expressly disclaims any duties or obligations towards any person or entity that may result from using this attached Manual. Kindly also note that this Manual does not express any conclusion about the Proper Accounting Treatment based on specific facts and does not recommend accounting policies or treatments that the user of this Manual shall choose or apply.

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Introduction

Purpose of Manual:

This Manual aims to provide a summary of the most important effects that resulted from the transition to International Financial Reporting Standards (IFRSs) at the expense of Zakat. It should be noted here that the mentioned standards were adopted by the Saudi Organization for Chartered and Professional Accountants to become applicable by companies listed in the Saudi Financial Market effective from the Fiscal Year January 1, 2017.

Further, this Manual is intended to contribute to raising awareness on changes in the accounting treatments contained in international standards, which may have changed the Zakat handling for some items. ZATCA aims that the Manual will also contribute to narrowing the gap between the understanding of taxpayers and the Authority's expectations concerning the mechanisms for estimating and calculating Zakat in light of the transition to these standards.

This Manual addresses the following international standards:

- IAS No. 2 "Inventories"
- IAS (16) "Property, Plant and Equipment"
- IFRS 13 "Fair Value Measurement"

The Manual has been prepared based on the International Financial Reporting Standards approved in the Kingdom of Saudi Arabia (issued in 2020 AD).

Overview of the transition to the approved International Financial Reporting Standards in the Kingdom of Saudi Arabia:

International Financial Reporting Standards have been endorsed by the Saudi Organization for Chartered Auditors and Accountants to become applicable by companies listed in the Saudi financial market effective from the fiscal year 1 January 2017.

In the interest of the Zakat, Tax and Customs Authority to keep pace with this fundamental transition, the Authority has listed and formulated the most prominent effects of the transition on the account of Zakat for private sector companies and institutions in the Kingdom of Saudi Arabia.

1. Overview of IAS (2)

1.1. Standard objective:

The Objective of this standard is to define the accounting handling of inventory. One of the main topics in accounting for inventory is the amount of cost that will be recognized as an asset and carried forward until the related revenue is recognized. This standard provides guidance on determining the cost and its subsequent recognition as an expense, including write-down to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

1.2. Scope Summary:

Most Important Exceptions to IAS (2)	Applicable Standard	Standard Name
Financial Instruments.	IAS 32/IFRS 9	IAS No. (32) Financial Instruments: "Presentation IFRS 9 "Financial Instruments".
Accounting for biological assets and agricultural activity and product at the point of harvest.	IAS (41)	IAS (41) "Agriculture".

This Standard does not apply to the measurement of inventory retained by:

Producers of agricultural and forest products, agricultural production after harvest, minerals and metal products, to the extent that they are measured at net realizable value in accordance with practices in those industries; (when such inventories are measured at net realizable value, changes in that value are recognized in profit or loss in the period change). Brokers are commodity dealers who measure their inventory at fair value less sale costs. Upon measuring such inventory at fair value minus selling costs, changes in fair value minus selling costs are recognized in profit or loss in the period of change.

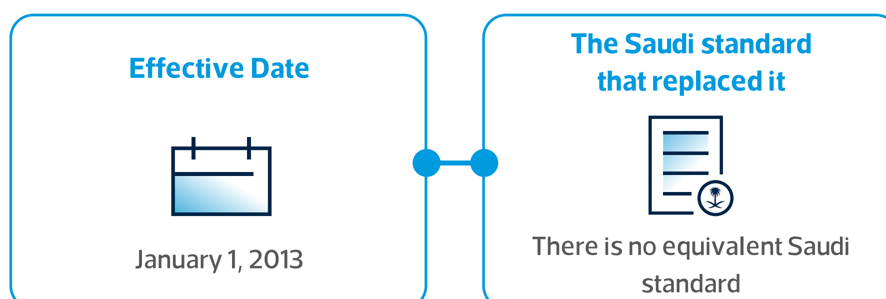
2. Overview of IAS (16)

2.1. Standard objective:

The objective of this Standard is to define the accounting handling of property, plant and equipment, so that users of financial statements can distinguish information about an entity's investment in its property, plant and equipment, and changes in such investment. The main topics in accounting for real estate, plant and equipment are the recognition of assets and their carrying amounts, and the depreciation charges and impairment losses related to them to be recognized.

2.2. Scope Summary:

Most Important Exceptions to IAS (16)	Applicable Standard	Standard Name
Property, plant, and equipment classified as held for sale.	IFRS (5)	IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations".
Biological Assets related to agricultural activity other than fruiting plants. This standard applies to bearer plants, but not to agricultural products grown on bearer plants.	International Accounting Standard (41)	IAS 41 "Agriculture".
Recognizing and measuring the assets of exploration and evaluation.	IFRS (6)	IFRS 6 "Exploration and Valuation of Mineral Resources".
An entity that uses the investment property cost model in accordance with IAS 40 shall use the cost model in this standard for investment property owned.	International Accounting Standard (40)	IAS (40): Investment Property



3. Overview IFRS No. (13)

3.1. Standard objective:

- **This standard:**

A. Defines fair value.

B. introducing a single set of requirements for fair value measurements.

C. It requires disclosures about fair value measurements.

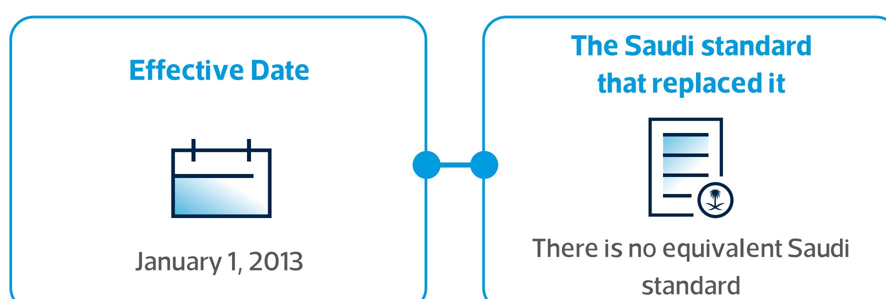
- Fair value is a "market-based measurement" rather than an entity-specific measurement. Some assets and liabilities may have observable market transactions or observable market information, and while other assets and liabilities may not have observable market transactions or observable market information. However, the objective of the fair value measurement in both cases is the same: Estimating the price at which a transaction would take place under regular arm's length conditions to sell the asset, or transfer the liability between market participants at the measurement date under current market conditions (i.e., the exit price at the measurement date from the perspective of a market participant who holds the asset or owes the liability)

- When there is no observable price for a matching asset or liability, the entity measures fair value using another valuation technique that maximizes the use of appropriate observable inputs and minimizes the use of unobservable inputs. As the fair value measurement is market-based, then it shall be measured using the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. As a result, the entity's intention to hold an asset, settle a liability, or otherwise discharge it is not relevant in the fair value measurement.

- The definition of fair value focuses on assets and liabilities; because they are the main subject of accounting measurement. In addition, this Standard shall be applied to the entity's own equity instruments measured at fair value.

3.2. Scope Summary:

Most Important Exceptions to IAS (2)	Applicable Standard	Standard Name
Share-based payment transactions.	IFRS (2)	IFRS (2) 'Share-Based Payment'.
Lease transactions.	IFRS (16)	International Financial Reporting Standard (16) "Lease Contracts".
Measurements that have some similarities to fair value, but are not fair value, such as: Net realizable value, or value in use.	International Accounting Standard (2) International Accounting Standard (36	IAS No. 2 "Inventories" IAS No. 36 "Impairment of Assets"
Disclosures Plan assets measured at fair value.	International Accounting Standard (19)	International Accounting Standard (19) "Employee Benefits".
Disclosures Retirement benefit plan investments measured at fair value	International Accounting Standard (26)	IAS 26 Accounting and Reporting by Retirement Benefit Plans
Disclosure of assets for which the recoverable amount is fair value less costs of disposal.	International Accounting Standard (36)	IAS No. 36 "Impairment of Assets"

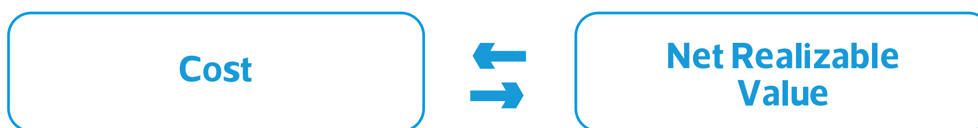


4. Recognition and Measurement Requirements

4.1. IAS No. 2 “Inventories”

4.1.1 Basic principle:

Inventories shall be measured at the lower of cost or net realizable value



4.1.2 Costing Methods:

Not interchangeable items

Cost = actual expenses incurred

Important Points:

The entity shall use the same cost method for all inventory items of a similar nature and use to the entity.
For inventory items with a different medical or usage, different costing methods may be justified.
The last-in, last-out method is prohibited.

Interchangeable items

The first-in-first-out method assumes a physical flow of items, i.e. inventory items purchased or produced first are sold first

Weighted average cost. This method calculates the average purchase or production (the average could be calculated on a turn-by-turn basis, or when each additional shipment is received or a new batch is produced) and the inventory will be valued at the weighted average Zakat.

4.1.3. Cost Components:

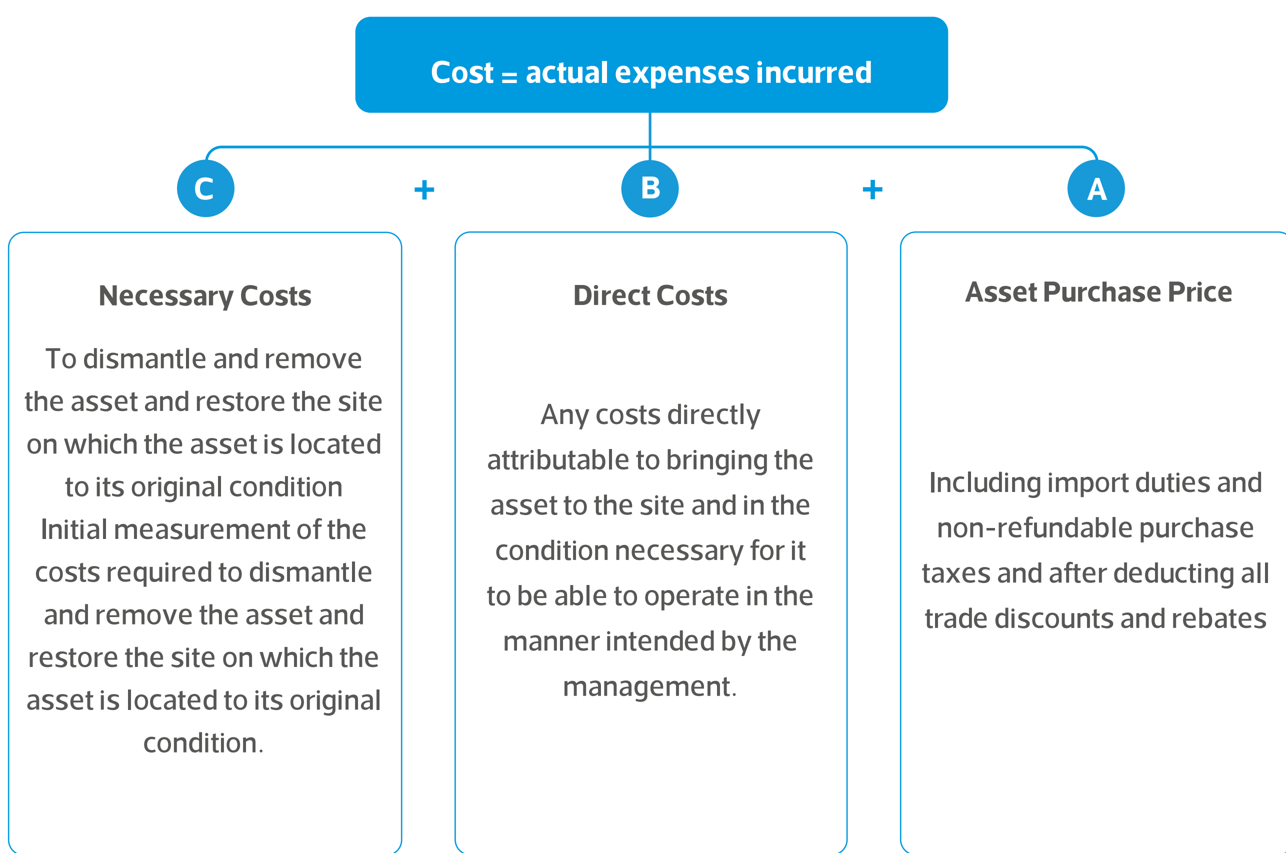
Include
The purchase price of goods acquired for resale or raw materials to be used in the production process Any discounts or rebates should be deducted from the cost
Costs that are directly attributable to bring the situations to its present condition, these may include import duties, transportation and other handling costs.
In the case of a production or conversion process, direct manufacturing costs and direct labor plus the systematic allocation of fixed costs (costs that will be incurred regardless of the level of production) and variable costs (costs determined based on the level of production) are included in the cost.
Other costs incurred to bring inventory to its present location and condition, for example, it may be appropriate to include non-production overheads, or design costs for customers' products identified in the cost of inventory.

Doesn't include
Non-common amounts of lost raw materials, labor or other production costs.
Storage costs, unless these costs are necessary in the production process prior to another production stage.
Additional administrative expenses that don't contribute to bringing the inventory to its present location and condition.
Sale Costs
Interest cost (where settlement is deferred) - IAS 23 (Borrowing Costs) identifies the rare circumstances in which assumption costs can be included
It will be recognized as expenses in the period in which they are incurred

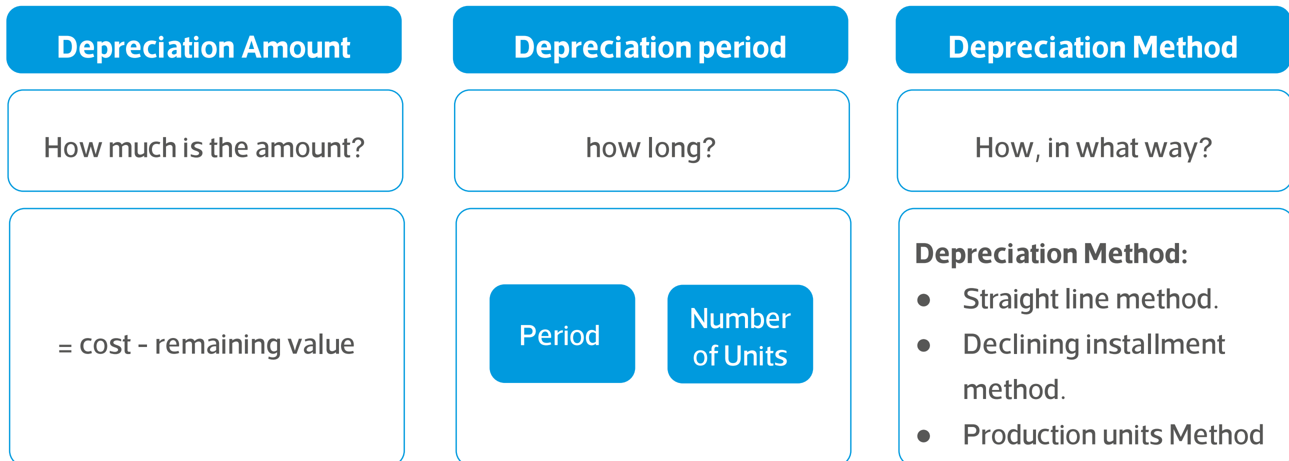
4.2. International Accounting Standard (16)

IAS 16 states that the cost of an item of property, plant and equipment should be recognized as an asset when, and only when:	
It is expected that future economic benefits will flow to the entity from this item.	The cost of the item can be measured reliably.
This recognition principle shall be applied to all costs in the period in which they are accrued	
Costs incurred, primarily, for the acquisition or the construction in the item of real estate, plant and equipment.	The costs incurred, later, to add to it, or to replace part of it, or maintenance of it.

4.2.1. Initial and Subsequent Expenses:



4.2.2. Depreciable amount and Remaining Values

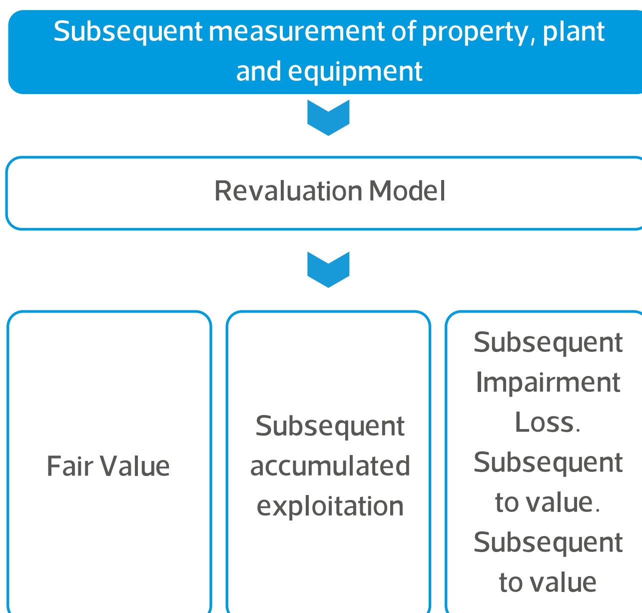


It must be re-evaluated at least at the end of each fiscal year:

- Remaining Value:
- Useful life.
- Appropriate Depreciation Method:

4.2.3. Revaluation Model

- As per IAS 16, a valuation by an expert appraisal (required under IFRS as applied in Saudi Arabia) is recommended.
- The entire asset class shall be revalued
- The asset class shall be revalued on a frequent basis

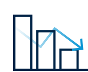


The change in the carrying amount of the asset as a result of the revaluation should be handled with in the following manner:

Increase

Credit to equity through other comprehensive income - revaluation surplus.

Credit to Profit and Loss - to reverse the previous decrease in Profit and Loss.



Decrease

Debit to equity through other comprehensive income - to reflect the increase in the revaluation surplus.

Debit to profit and loss if there is no credit balance in other comprehensive income.

4.3. IFRS No. (13)

4.3.1. About Fair Value Hierarchy:

IFRS No. (13) introduces a fair value hierarchy, which classifies inputs to valuation methods into (3) levels. The highest priority is given to level (1) inputs, and the lowest priority to (3) level inputs. The entity shall, to the greatest extent possible, use inputs of level (1), and shall, as far as possible, reduce the use of inputs of equals (3).

Level one → Quoted prices in active markets for identical assets or liabilities. → A quoted market price in an active market provides the most reliable evidence of fair value and is used, without amendment, for a fair value measurement where available, with limited exceptions.

Level Two → Other than a level 1 market that is observable for the asset or liability, either directly or indirectly, level 2 inputs include:

- Quoted prices for identical assets or liabilities in active markets
- Quoted prices for identical or similar assets or liabilities in inactive markets
- Inputs other than quoted prices that are observable for the asset or liability
- Supporting inputs from the market:

Level Three → The unobservable input is the asset or liability

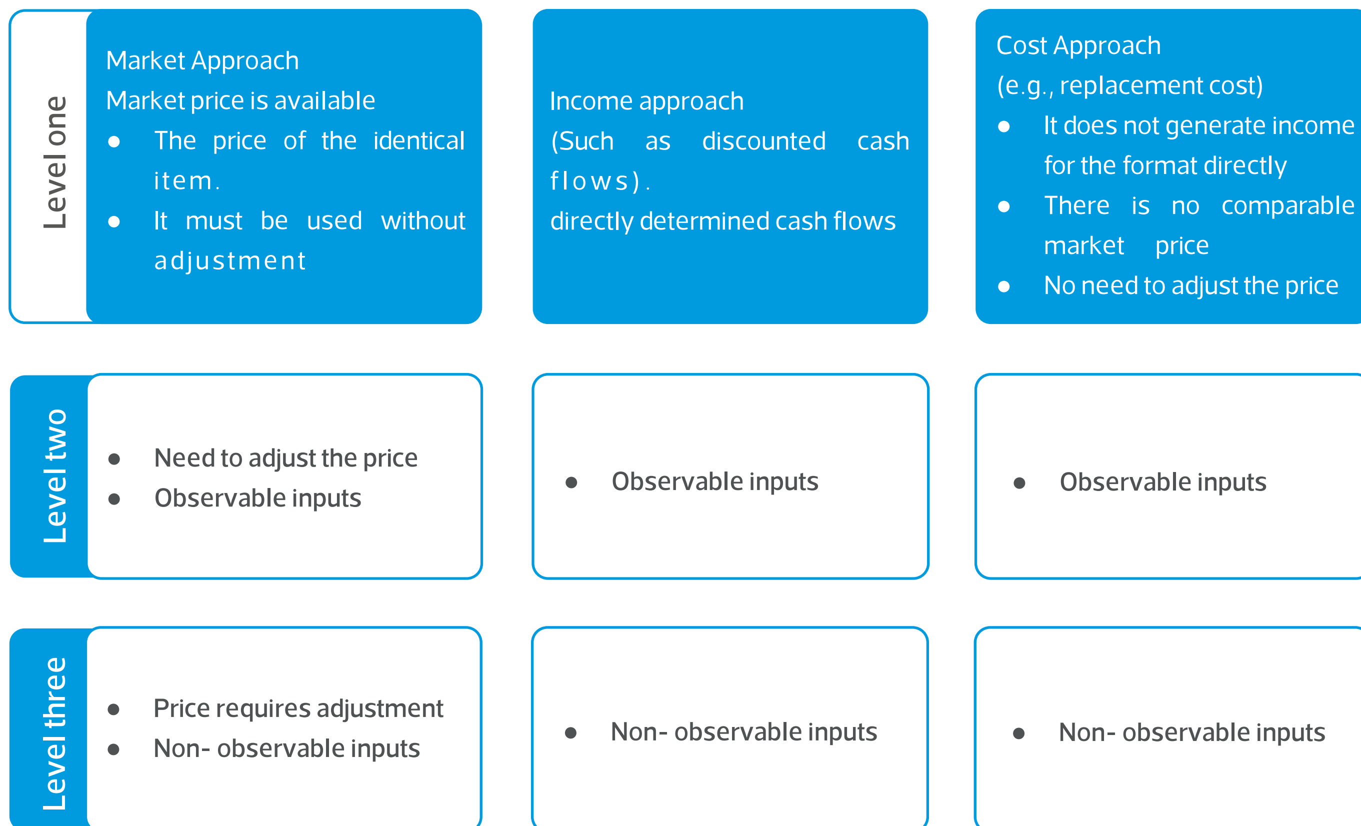
- The entity develops inputs using the best information available under the circumstances, which may include entity-specific data, considering all information about market participants' assumptions reasonably given.
- Unobservable inputs of the asset or liability: It is used to measure fair value to the extent that no observable appropriate input is available, allowing for situations in which there slight, if any, market activity for the asset or liability at the measurement date.

IFRS 13 applies to international financial reporting standards that require or permit fair value measurements or disclosures and "provide a single IFRS framework for fair value measurement" in addition to require disclosures about fair value measurements.

4.3.2. Overview

<table>
<tr><th>Standard</th><th>Asset Type</th><th>Measurement at initial recognition</th><th>Post-recognition measurement model based on fair value</th><th>The basis for the decline in the value of assets</th></tr>
<tr><td>IFRS (9)</td><td>Financial Instruments.</td><td>In fair value.</td><td>Specific financial assets and business models: In fair value.</td><td></td></tr>
<tr><td>International Accounting Standard (16)</td><td>property, plant and equipment</td><td>Purchase cost + construction costs + costs, refer to bringing the asset to the location and condition necessary for it to be able to operate in the manner intended by management.</td><td>Accounting policy option: Revaluation Model</td><td rowspan="2">Comparing the carrying amount of the asset to its recoverable amount. The recoverable amount is the fair value of the asset less costs to sell or its value in use, whichever is higher (IAS (36)).</td></tr>
<tr><td>International Accounting Standard (38)</td><td>Intangible Assets</td><td>Purchase cost + development costs + costs attributable to bringing the asset to the condition necessary for it to be able to operate in the manner intended by management.</td><td>Accounting policy option: Revaluation Model</td></tr>
<tr><td>International Accounting Standard (40)</td><td>Investment Real Estate</td><td>Costs including transaction costs.</td><td>ccounting policy option: In fair value.</td><td></td></tr>
<tr><td>International Accounting Standard (41)</td><td>Biological assets.</td><td>At asset's fair value less costs to sell.</td><td>At the asset's fair value less costs to sell.</td><td></td></tr>
</table>

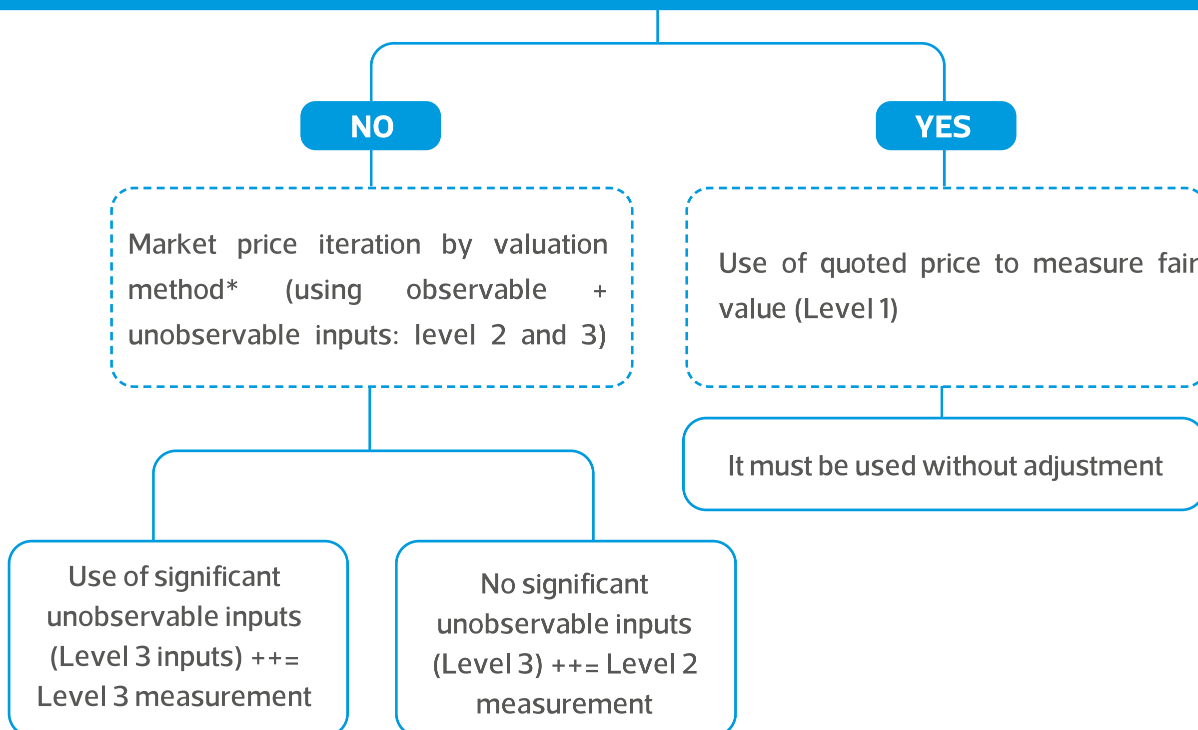
4.3.3.1 Approaches to measuring fair value:



Approaches Method of Evaluation	Evaluation Methods
Approach market method	• The transaction price paid for an identical or similar instrument • Comparable multiples to evaluate the establishment
(Approach) method of income	• Discounted cash flow method • Dividend discount model • Constant- growth dividend discount model • Capitalization model
Using a set of approaches	• Adjusted net asset value methodology.

4.3.3. How do we conduct market-based measurement?

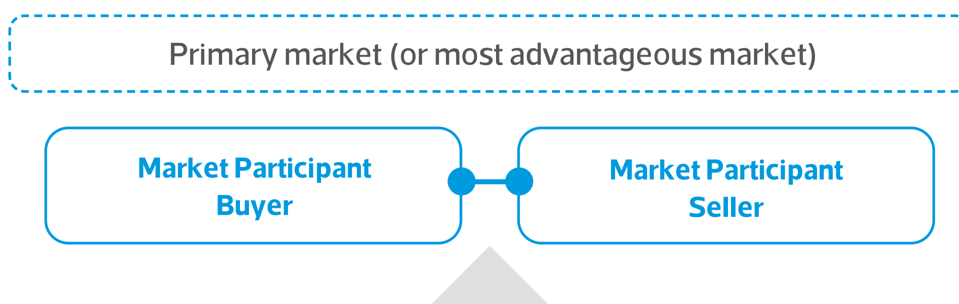
IFRS 13 applies to international financial reporting standards that require or permit fair value measurements or disclosures and "provide a single IFRS framework for fair value measurement" in addition to require disclosures about fair value measurements.



* Evaluation methods include: Market approach, income approach, and cost approach.

* Use, to the extent possible, appropriate observable inputs, and reduce, to the maximum extent possible, non-observable inputs, observable inputs include: Market data (prices and other information available to the public).

*** Unobservable entries include: Entity-specific data (budgets and forecasts), which shall be adjusted if market participants are going to use different assumptions.



at the date of measurement (For the asset to commit) Fair Value

5. Impact of Transition to IAS 2 on the Zakat Base

5.1. Introduction

In view of the aspects covered by International Accounting Standard No. 2 from the accounting point of view, the most important items that can be addressed in terms of Zakat are as follows:

- The most significant effect on the adjusted net profit or loss for zakat purposes (minimum base) is for taxpayers who were allowed by the standards before the transition to use the last-in-first-out method and who switched to using the methods recognized after the transition to the new standard (first-in, first-out or weighted average method). The assumed effect is the increase in profit or loss for zakat purposes after the transition, however, the post-transition effect does not require an adjustment for zakat purposes.
- In all cases, with regard to the remaining elements of the Zakat base such as additions and deductions, the stock of end-of-term goods recognized in the financial statements is considered among the current assets. These assets are not permissible for deduction from the Zakat base and which are not stipulated in Article Five of the Regulations within the deductions from the Zakat base.
- In cases where the inventory is considered part of the components of the deductible asset (such as spare parts that are not intended for sale), this will not have an effect on the Zakat base, as the aforementioned inventory item is by nature deducted from the Zakat base according to Article Five. Instead, it will be consumed as part of the asset and deducted at the book value. However, this effect will be offset by the amount of depreciation recognized in profit or loss.

6. Impact of Transition to IAS 16 on the Zakat Base

Introduction

In view of the aspects covered in IAS 16 and the differences in the accounting treatment of some aspects, the elements of these accounting differences should be viewed together with the following articles of the regulation:

- **Depreciation Method**

The first and fourth paragraphs of Article 8:

"The following expenses may be deducted to determine the net result of the activity:

First Paragraph: Ordinary and necessary expenses required for the activity. The following controls shall be provided:

A. The expenses shall be actual and supported by documents and evidence accepted by the Authority and could be verified, even if it was related to previous years.

B. To be related to the activity of the taxpayer, and not related to personal expenses or other activities that do not belong to the taxpayer.

C. It shall not be of a capitalistic nature. In the event that an expense of a capital nature is included in the expenses; it shall be adjusted as a result of the activity and is added to the fixed assets and consumed within the depreciation of the asset.

Fourth paragraph: The annual depreciation premium for the fixed assets owned by the taxpayer and intended for use in the activity according to what is recorded in the commercial books, unless the Authority proves that the taxpayer exaggerated the premium.

- The value of the fixed asset deducted from the zakat base.

Article Five, Paragraph D of the first clause and the sixth article of the aforementioned article:

"The following items shall be deducted from the Zakat Base (ZB) of the taxpayer who keeps commercial books:

Net fixed assets and its equivalent.

- Revaluation Reserve

The third and tenth paragraph of Article Four

"The taxpayer's zakat base who maintain the commercial books consists of all his funds subject to zakat collection, including the following:

Third Paragraph: "Debts owed by the taxpayer classified as long-term, and equivalent from other components of the base, such as: Government finance, trade finance creditors, notes payable, overdraft account and loans to owners or partners. etc."

Paragraph Ten: "Any item of liabilities and equity shall be financed from the deducted items from Zakat base."

6.1. ZB Financial Impact of the Transition

Referring to the impact of the transition to International Accounting Standard No. 16 from the accounting point of view, it is necessary to refer to the most prominent items that may have an impact on the Zakat base as follows:

1. Revaluation Surplus: The recognition of the re-valuation surplus affects the items of fixed assets when deducted from the Zakat base due to the re-valuation of the asset at a fair value that exceeds the book value of the same asset (only available for unlisted establishments/ allowing listed companies starting from the first of January 2022 AD for real estate only). This also affects the book depreciation by an increase due to the depreciation of the asset at the revalued value. This results in a decrease in the zakat base, including the minimum base, unless this is treated by taking into account the revaluation of surplus recognized in the statement of other comprehensive income in accordance with the Levying Zakat Executive Regulations (paragraph six of Article 6, which requires taking into account the results of changes in fair value for zakat purposes. Further, adding the revaluation surplus to the fair value is also in line with the provisions of the tenth paragraph of Article 4, since this item is directly linked to an item of the maintenance items of the zakat base.
2. Provision for disassembly and removal: The recognition of the obligation (provision) for dismantling and removal affects the Zakat base by an increase, although this recognition affects the book value of the asset by an increase as well, as a result of capitalizing this provision over the cost of the asset.

3. Impairment losses: The decrease in the value of the asset does not affect the Zakat base when taking into account the impairment loss recognized in the profits and losses as expenses for the deduction in line with the sixth paragraph of Article Six in the executive regulations for the collection of Zakat, and at the same time, the asset is deducted at the book value after deducting the impairment loss.

6.2. Proposed Zakat Base Financial Implications Handling

In view of the most prominent items that were introduced as a result of the transition to the aforementioned international accounting standard, zakat handling for the most important items is summarized as follows:

Item	Zakat Handling
Revaluation Surplus	• Deduction of the value of the asset to be revalued from the base. • Adding the revaluation surplus to the zakat base.
Provision for disassembly and removal	• Adding the provision to the zakat base • Adjusting the result of the activity in the component during the year. • Deduction of the value of the asset, including the increase resulting from the provision.
Impairment losses	• Non-adjustment of the result of the activity with the provision for impairment losses. • Deduction of the net asset value reduced by the accumulated impairment losses

7. Impact of Transition to IFRS 13 on the Zakat Base

This standard refers mainly to the methodology adopted for measuring fair value through its definition and adoption of a single framework for its measurement in addition to the disclosures in the financial statements about the measurement of fair value.

By referring to the details covered by the standard, it is noted that it does not measure the financial impact on the items of the financial statements, but rather sets a framework for measuring the fair value of items that are handled in other separate accounting standards, taking into account the exceptions specified in the standard. These standards are as follows for example (but not limited to):

- IAS No. 2 "Inventories"
- International Accounting Standard 16 (Property and Equipment).
- Financial Reporting Standard No. 9 (Financial Instruments).

Referring to the standards sections in this Manual, the fair value measurement of the aforementioned items and how to handle zakat effect, if any, were addressed.

8. Theoretical Examples on the Effect of Transition on ZB

8.1. International Accounting Standard 16

Example (1) Reevaluation:

- Establishment (S) purchased an asset for 50,000 Saudi riyals, and it is being depreciated over 8 years.
- Four years later, the asset was revalued to SAR 48,000.
- The (remaining) life estimate remains unchanged i.e., 4 years.
- Accumulated depreciation amounting to (50,000 Saudi riyals / 8 years) x 4 years = 25,000 years = 25,000 Saudi riyals was determined against the total cost of the asset to assign a book value of 25,000 (50,000 Saudi riyals less accumulated depreciation by 25,000 Saudi riyals) on the date of revaluation.
- The book value of SAR 25,000 was compared to the revalued amount of SAR 48,000 and the difference of SAR 23,000 was recognized in other comprehensive income in equity under the item (revaluation surplus).
- In light of the above, the subsequent depreciation for the remaining years will be 12,000 Saudi riyals per year (48,000/4).

The excess reevaluation can be handled with in the future under two options:

First Option: Gradual transition with depreciation premium each year		
Transfer an amount equal to excess depreciation (SAR 12,000 - SAR 6,250) from the revaluation reserve to retained earnings over the remaining life of the asset:		
Debit	Revaluation Reserve (Other Comprehensive Income)	5,750
Credit	Retained Earnings	5,750

Second Option: Transfer upon disposal		
Transfer from the revaluation surplus account to the retained earnings upon disposal of the asset due to the accounting entry.		
Debit	Revaluation Reserve (Other Comprehensive Income)	23,000
Credit	Retained Earnings	23,000

Summary (assuming the first option is used to transfer the reevaluation surplus to the retained earnings):

1. Cost Model (Before Transition)											
Year		0	1	2	3	4		5	6	7	8
The asset's book value less accumulated depreciation	A	50,000	43,750	37,500	31,250	25,000		18,750	12,500	6,250	-
Depreciation	B	-	(6,250)	(6,250)	(6,250)	(6,250)		(6,250)	(6,250)	(6,250)	(6,250)
2. Re-evaluation form (adopted after transition)											
Year		0	1	2	3	4	Re-evalua-tion	5	6	7	8
Asset Book Value	C	50,000	43,750	37,500	31,250	25,000	48,000	36,000	24,000	12,000	-
Depreciation	d	-	(6,250)	(6,250)	(6,250)	(6,250)		(12,000)	(12,000)	(12,000)	(12,000)
Effect on recycled profits or losses	d-b	-	-	-	-	-	-	(5,750)	(5,750)	(5,750)	(5,750)
The nature of the effect		-	No effect	No effect	No effect	No effect	-	Large Discount	Large Discount	Large Discount	Large Discount
The impact on the zakat base (deductions)	C-A	-	-	-	-	-	-	(17,250)	(11,500)	(5,750)	-
The nature of the effect		-	No effect	No effect	No effect	No effect	-	Large Discount	Large Discount	Large Discount	-

It is noted that the final result is a decrease in the zakat base resulting from the increase in the value of the asset as a result of the re-evaluation and the increase in depreciation expense during the useful life remaining after the re-evaluation

Referring to the summary of the operations above, it shall be noted that the results of the revaluation affected the increase in the value of the asset deducted from the base and the value of depreciation. Accordingly, to handle this effect in accordance with the Regulations, zakat handle shall be summarized by adding the revaluation surplus balance as follows:

Revaluation Model									
Year	Reference	1	2	3	4	5	6	7	8
1. Effect on profits or losses	A	-	-	-	-	(5,750)	(5,750)	(5,750)	(5,750)
The nature of the effect		No ffect	No effect	No effect	No effect	Large Discount	Large Discount	Large Discount	Large Discount
Impact handling: Carrying forward the revaluation surplus to retained earnings	B	-	-	-	-	-	5,750	11,250	17,250
The effect of additional depreciation on retained earnings							(5,750)	(11,250)	(17,250)
Net effect (extra depreciation on profit or loss)	D = A + B+ C	-	-	-	-	(5,750)	(5,750)	(5,750)	(5,750)
2. The impact on the zakat base (discounts)	E	-	-	-	-	(17,250)	(11,500)	(5,750)	-
The nature of the effect		No effect	No effect	No effect	No effect	Large Discount	Large Discount	Large Discount	-
Impact handling: Adding the revaluation surplus balance to the zakat base to equalize the effect.	F	-	-	-	-	23,000	17,250	11,500	5,750
Net effect	D + E + F	-	-	-	-	-	-	-	-

Example (3)

- Company A is a manufacturing company.
- On January 1, 2017, the company estimated that it must dismantle its manufacturing equipment after 8 years, with the expectation that the amount allocated for this process will be 1,000,000 Saudi riyals.

Interest Rate	3%
The discount factor is 1/ (1+3%) ^ 8	0.789
Present value of the amount (SAR)	789,409

Accounting Entries

January 1	Initial recognition	Debit	Credit
1	Assets	789,409	
	Provision for disassembly and removal (obligation)		789,409
December 31, 2017	Interest Expense	Debit	Credit
2	Interest Expense	23,682	
	Provision for disassembly and removal		23,682
December 31, 2017	Asset depreciation	Debit	Credit
3	Depreciation Expense	98,676	
	Accumulated Depreciation		98,676

Summary of operations over the useful life of the sent asset at the expense of industrial equipment:

Item	Note	Reference	1/1/ 2017 AD	2017 AD	2018 AD	2019 AD	2020 AD	2021 AD	2022 AD	2023 AD	2024 AD	2025 (Provision Paid)	Total/Total effect
Depreciation over 8 years as part of the assets	Profit or Loss	A		(98,676)	(98,676)	(98,676)	(98,676)	(98,676)	(98,676)	(98,676)	(98,676)	-	(789,409)
Financing Expenses	F	B		(23,682)	(24,393)	(25,125)	(25,878)	(26,655)	(27,454)	(28,278)	(29,126)	-	(210,591)
Assets	Assets	C	789,409	789,409	789,409	789,409	789,409	789,409	789,409	789,409	789,409	-	
Accumulated Depreciation	Account against the asset	d		(98,676)	(197,352)	(296,028)	(394,705)	(493,381)	(592,057)	(690,733)	(789,409)	-	(789,409)
Asset Book Value		E= C-D		(690,733)	(592,057)	(493,381)	(394,705)	(296,028)	(197,352)	(98,676)	-	-	-
Removal and dismantle provision*	liabilities + interest	F	789,409	813,092	837,484	862,609	888,487	915,142	942,596	970,874	1,000,000	-	-

* Balance of provision for dismantling and removal = balance as at the end of the previous year (retained balance) * (1 + 3%)

Zakat purposes		1/1/2017 AD	2017 AD	2018 AD	2019 AD	2020 AD	2021 AD	2022 AD	2023 AD	2024 AD	2025 (Provision Paid)	Total/Total effect
Depreciation	F	-	(98,676)	(98,676)	(98,676)	(98,676)	(98,676)	(98,676)	(98,676)	(98,676)	-	(789,409)
Financing Expenses	G	-	(23,682)	(24,393)	(25,125)	(25,878)	(26,655)	(27,454)	(28,278)	(29,126)	-	(210,591)
Total expenses for the period	H=F-G	-	(122,358)	(123,069)	(123,801)	(124,554)	(125,331)	(126,130)	(126,954)	(127,802)	-	(1,000,000)
Returned: Accrued from Provisions During the Year	I	-	23,682	24,393	25,125	25,878	26,655	27,454	28,278	29,126	-	-
Total expenses after adjustment	J	-	(98,676)	(98,676)	(98,676)	(98,676)	(98,676)	(98,676)	(98,676)	(98,676)	-	-
Discounts												
Assets	K	-	(690,733)	(592,057)	(493,381)	(394,705)	(296,028)	(197,352)	(98,676)	-	-	
Addition to the zakat base												
Provision as at the end of the year (beginning balance of the period less used or reversed if any)	L	-	789,409	813,092	837,484	862,609	888,487	915,142	942,596	1,000,000	-	-
The effect on the retained earnings	#	-	-	(122,358)	(245,427)	(369,228)	(493,782)	(619,113)	(745,224)	(872,198)	-	-
added to the zakat base												
Net (extras minus rebates)		-	-	-	-	-	-	-	-	-	-	-

From the above, it is noted that the handling of items for zakat purposes did not have an impact on the zakat base.

8.2. International Accounting Standard 2

Example (1):

Company ABC is a newly established trading company. It started its work in 2018. The company imports goods from China and sells it in the local market. The following is a list of purchases and sales made by the establishment during the year 2018:

Purchases	Number of Units
January 2018 AD	10,000 units at 25 Saudi riyals each
May 2018 AD	15,000 units at 30 Saudi riyals each
September 2018 AD	20,000 units at 35 Saudi riyals each
Sales	**Number of Units**
May 2018 AD	15,000 units
November 2018 AD	20,000 units

Using the following method: First in first out, weighted average method, last in first out method, calculate the inventory value on May 31, September 30, and December 31, 2018.

1. **Calculating the cost of sales for the year 2018 according to the first-in, first-out method:**

Sale Period	Number of Units	Unit Cost	Total Cost
May	10,000	25	250,000
	5,000	30	150,000
November	10,000	30	300,000
	10,000	35	350,000
	Total		1,050,000

2. **End-of-period inventory value according to the first-in, first-out method:**

Sale Period	Number of Units	Unit Cost	Total Cost
November	10,000	35	350,000
	Total		1,050,000

3. Calculating the weighted average per unit:

Date	Number of Units	Unit Cost	Total Cost
January	10,000	25	250,000
May	15,000	30	450,000
November	20,000	35	700,000
Total	45,000(0)		1,400,000 (1)
Total			31.11

- **Cost of goods sold according to the weighted average method:**

Number of Units	Unit Cost	Total Cost
35,000	31,11	1,088,850

The value of inventory at the end of the period according to the weighted average method:

Number of Units	Unit Cost	Total Cost
10,000	31,11	311,100

4. Calculating the cost of sales for the year according to the first-in, first-out method:

Date	Number of Units	Unit Cost	Total Cost
September	15,000	30	250,000
November	20,000	35	700,000
Total			1,150,000

- **End-of-period inventory value according to the last-in-first-out method:**

Date	Number of Units	Unit Cost	Total Cost
September	10,000	25	250,000
Total			250,000

Summary:

Item	Number of Units	Unit Cost
Cost of goods sold	First in first out	1,050,000
	Weighted Average	1,088,850
	Last in first out	1,150,000

- From the above, it is noted that the last-in-first-out method resulted in a (higher) cost of goods than other approved methods in accordance with International Accounting Standard No. 2. It should be noted that the last-in, first-out method is also approved alongside other methods before transformation, but after transition it is not allowed to be used. As after transition only the First-int - First- Out method is allowed to be used (or) the weighted average method.
- The impact on zakat base lies with the taxpayers who use the last-in, first-out method, and after the transition to using other methods, which in most cases will result in a decrease in the cost of goods sold, which affects the profit subject to zakat inversely (by decreasing if other methods are used).

Example (2)

On December 31, 2018, an establishment had inventory that cost SAR 61,000 and the estimated selling price of the inventory was SAR 58,000 and the estimated selling costs were SAR 3,000:

Required Action

1. Determine the net realizable value of the inventory and the amount of impairment loss on inventory.
2. Evidence of the journal entry in the books
3. Determine the inventory value that will appear in the company's budget as of December 31, 2018.

Reference to the above data, the inventory value that will appear in the books of the company will be deduced on the basis of:

Cost	Amount (SAR)
Cost	61,000
Net Realizable Value	55,000 = 3,000-58,000
Inventory cost (whichever is lower)	55,000
The amount of inventory impairment loss	(6,000) = 61,000-55,000

Accordingly, the value of inventory that is recorded in the books is 55,000 SAR.

- **Recognition of an inventory impairment loss:**

Value	Debit	Credit
From Sales or losses impairment cost account	6,000	
The account of Inventory (Last Term)		(6,000)

Referring to the results of the application and after reducing the value of the inventory at the end of the period and recognizing the decrease loss, the question arises about the extent to which this loss is considered as a deductible expense for the purposes of Zakat.

Referring to handling of the new standard and mentioning it for the accounting handle explicitly, the requirement of the standard for calculating the net realizable value is based mainly on the selling price in the market less the estimated costs of the sale process, i.e., in case the company sold the inventory immediately in the subsequent period, then the goods will be sold at the same calculated value (realizable value). For example, in the previous example, the inventory was reduced to 55,000, and the selling price was also SAR 55,000, i.e., the sale amount equals the cost in the subsequent period, and no additional loss will be recognized since the loss was recognized in the previous period.

In the light of the above, it could be concluded that the recognized losses in the previous period is a loss realizable for the purposes of Zakat.

Noting that, the common practice before the transition was to value the inventory in the same way as after the transition.

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