



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 28 "Investments in Associates and Joint Ventures" and IFRS 10
"Consolidated Financial Statements"



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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 in the Manual are prepared 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.



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 1st, 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:

- International Accounting Standard (28) "Investments in Associates and Joint Ventures".
- International Reporting Standard (10) "Consolidated Financial Statements"

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 28 and IFRS 10

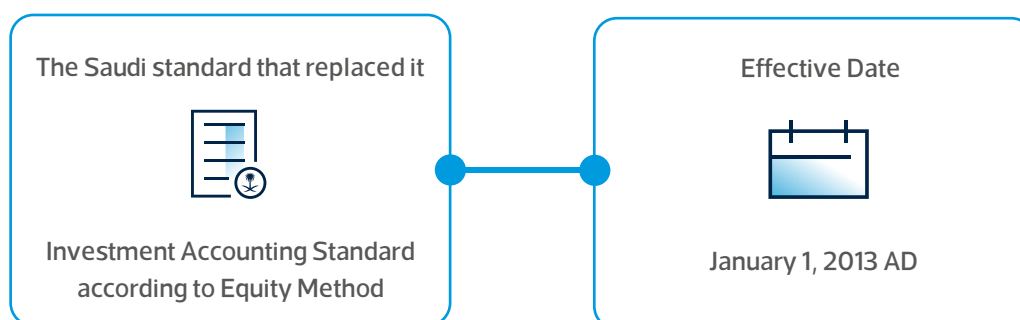
1.1. International Accounting Standard 28

1.1.1. Standard Objective:

The objective of this Standard is to describe the accounting for investments in associates and to specify the requirements for applying the equity method when accounting for investments in associates and joint ventures.

1.1.2. Standard Objective:

This Standard should be applied by all investment facilities with joint control or significant impact on an investee.



1.2. IFRS No. 10

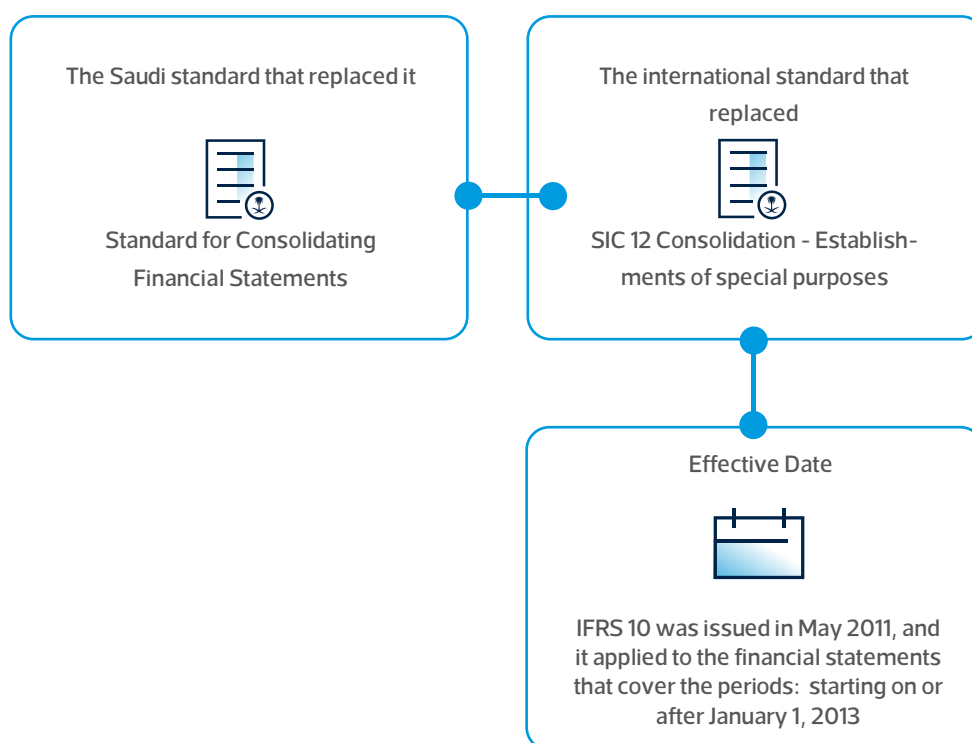
1.2.1. Standard objective:

The objective of this Standard is to establish principles for the presentation and preparation of the consolidated financial statements when an establishment controls one or more other establishments.



1.2.2. Scope Summary:

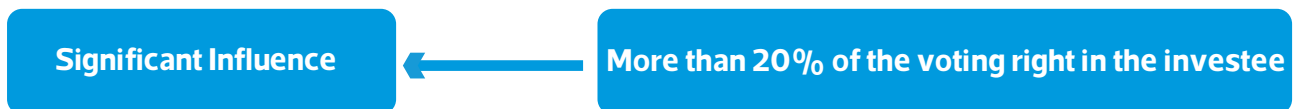
The Most Significant Exceptions to IFRS 10	Applicable Standard	Standard Name
This standard does not apply to post-employment benefit plans or long-term employee benefit plans.	International Accounting Standard 19.	International Accounting Standard (19) "Employee Benefits".





2. International Accounting Standard 28 Requirements

2.1. Significant Influence



Evidence of Significant Influence is usually established by an establishment, through one or more of the following ways:

1. Representation in the Board of Directors, or any equivalent governing body, of the investee.
2. Participation in policymaking processes, including participation in decisions about dividends or other distributions.
3. Transactions of material importance between the establishment and the investee establishment.
4. Exchange of administrative staff; or
5. Provision of basic technical information.



2.2. Equity Method of Accounting

According to the equity method, on initial recognition, the investment in an associate or a joint venture is recognized at cost. The book value is increased or decreased to demonstrate the investing establishment's share of the investee's profit or loss after the acquisition date.

Statement Profits or Losses

Share of profit or loss:

- The investing establishment's share of the profit or loss of the investee is recognized within the profit or loss of the investing establishment.

Statement of Financial Position

Investments in associates or joint ventures:

- Upon initial recognition, the investment in an associate or a joint venture is recognized at cost. The book value is increased or decreased to demonstrate the investing establishment's share of the investee's profit or loss after the acquisition date.
- Dividends received from the investee reduce the book value for investment.

Adjustments to book value may also be necessary for changes in the proportionate share of the investing establishment in the investee as a result of changes in the investee's other comprehensive income. These changes include those arising from the revaluation of property, plant and equipment, and from foreign exchange differences. The investing establishment's share of these changes is recognized within the other comprehensive income of the investing establishment.



2.3. Equity Method Procedures

Transactions with associates or joint ventures.

Gains and losses arising from “upward” and “downward” transactions between an establishment (including its consolidated subsidiaries) and its associate or joint venture are recognized in the entity’s financial statements only to the extent of unrelated investors’ shares in the associate or joint venture.

“Upward transactions” are, for example, sales of assets from an associate or joint venture to the investing establishment. “Downward transactions” are, for example, sales or contributions of assets from the investing establishment to its associate or joint venture.

The investing establishment’s share of the associate’s or joint venture’s gains or losses resulting from those transactions is eliminated.



2.4. Suspension of Equity Method

An establishment shall suspend using the equity method from the date on which its investment ceases to be an associate or a joint venture, as follows:

- If the investment becomes a subsidiary, the establishment shall account for its investment in accordance with IFRS 3 "Business Combination" and IFRS 10.
- When the retained share in the former associate or joint venture is a financial asset, the establishment shall measure the retained share at the fair value, and the fair value of the retained share shall be considered its fair value on initial recognition as a financial asset in accordance with IFRS 9. The establishment shall recognize in profit or loss any difference between:
 - Fair value of any retained share and any proceeds from disposal of a partial share in the associate or joint venture;
 - Book value of the investment at the date the equity method was suspended.
- When an establishment suspend using the equity method, the establishment shall account for all amounts previously recognized in other comprehensive income in respect of that investment on the same basis that would have been required if the investee establishment had directly disposed of its related assets and liabilities.



3. Requirements of IFRS 10

3.1. Control

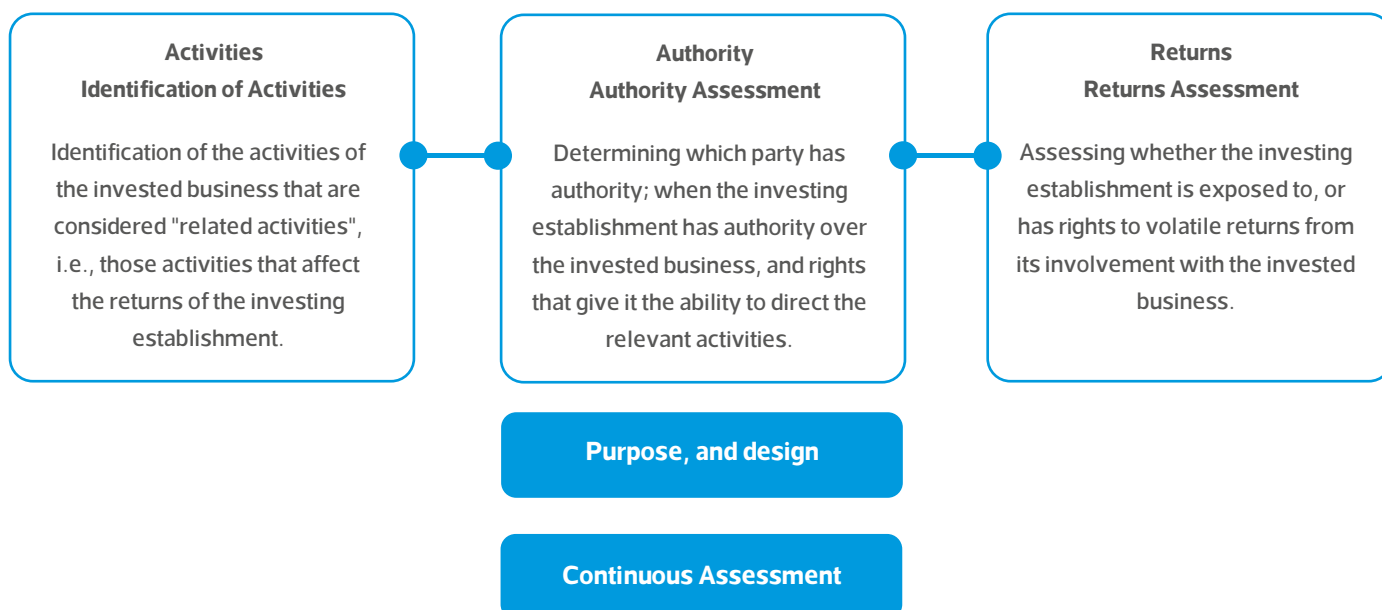
Consolidation Basis Control

- If the investing establishment controls the business of the investee establishment, then the investing establishment must consolidate the financial statements.
- If the investing establishment does not control the business of the investee establishment, the investing establishment cannot consolidate the financial statements.

What is control?

- **The investing establishment controls an investee establishment, when:**
 - Exposing to, or has rights to volatile returns from its involvement with the investee business.
 - Has the ability to use its power over the investee's business to influence the amount of returns of the investee.
 - Has the power over the invested business.

3.2. Control Assessment: Overview





3.3. Procedures for Consolidating Financial Statements

- Parent Establishment
- Independent Financial Statements
- Subsidiary
- Independent Financial Statements
- Set of Consolidated Financial Statements
- Consolidated Financial Statements for a group presented as one economic establishment

Step 1 Aggregation

Aggregation of similar items of assets, liabilities, equity, income, expense and cash flows of the parent establishment with its subsidiary.

Step 2 Exclusion

Cancellation (exclusion) of the parent establishment's investment in each subsidiary at the book value, and the parent establishment's share in the equity of each subsidiary.

Step 3 Transactions within Group

Assets, liabilities, equity, income, expense and cash flows relating to intra-group transactions are fully excluded.



4. Impact of Transition to IAS 28 on the Zakat Base

4.1. Introduction

In view of the aspects that were discussed in this study within the International Accounting Standard, most of its aspects can be linked to the investment item, which is covered by Article (5) of the Executive Regulations for the Collection of Zakat.

The fourth and fifth paragraphs of Article Five of the Regulations stipulate the following:

- **“The following items shall be deducted from the Zakat Base (ZB) of the taxpayer who keeps commercial books:**
 1. Investments in a non-trading entity inside the Kingdom, if that entity is registered with ZATCA, and is subject to levy of Zakat in accordance with the Regulations. Leased assets are not deemed financing, in the books of the lessor, as an investment that is deducted from ZB, regardless of its classification in the financial statements. Likewise, the debit loans or the supporting or additional financing and the like granted to the invested-in establishment are not deemed an investment deducted from ZB.
 2. Investments, for a non-trading purpose, in an establishment outside the Kingdom of Saudi Arabia, provided that the taxpayer pays zakat on said investments to ZATCA according to a certificate prepared in accordance with the provisions of the Regulations, which is approved by a chartered accountant licensed in the Kingdom of Saudi Arabia, provided that the minimum ZB for said investments is the taxpayer’s share of the incoming net accounting profit in the financial statements of said investments, whether the profit is distributed or not, and if the taxpayer does not commit to calculating and paying zakat accordingly, said investments shall not be deducted from ZB.



5. Impact of Transition to IFRS 10 on the Zakat Base

5.1. Introduction

Technically, there is a significant similarity in the method of consolidating the financial statements of the holding company and subsidiaries from the accounting point of view between the standard before the transition and the said standard that replaced it.

However, the basis for accounting consolidation under the new standard lies in the concept of control newly introduced.

6. Financial Impact of Transition to IAS 28 on the Zakat Base

In terms of the principle of deduction, the new standard had no effect on the eligibility for deduction of investment in associates or joint ventures from the zakat base. In both cases (the old standard and the new one that replaced it), these items will be subject to the provisions and controls stipulated in Article (5/4-5) of the Executive Regulations for the Collection of Zakat. In all cases, the zakat treatment for investments in associates and joint ventures can be summarized as follows:

- **Deductions:** After verifying the deduction conditions stipulated in the Regulations, the end-of-period balance of the investment shall be deducted from the zakat base.
- **Net Profit Adjusted for Zakat Purposes** the result of the activity is not adjusted for zakat purposes.



7. Financial Impact of Transition to IFRS 10 on the Zakat Base

In terms of zakat, the condition of consolidation for submitting a unified zakat declaration remains linked to the holding company's ownership of the subsidiaries (in full) to assess the extent to which a unified zakat declaration may be submitted in accordance with the provisions of the Executive Regulations for the Collection of Zakat, as follows:

- Companies owned by the partners themselves or the holding company and its wholly owned subsidiaries both inside and outside the Kingdom, whether with direct or indirect ownership, may submit unified accounts and a unified zakat declaration, and they are accounted for based on its results shown under one zakat base.
- Direct ownership means that the holding company fully owns the subsidiary by one hundred percent 100%. Indirect ownership means that the holding company owns the subsidiary by a certain percentage and the remaining percentages are owned by other subsidiaries wholly owned by the holding company.

This condition can be searched and verified in the same way provided for in the old and new standard, and therefore there is no direct financial impact resulting from the transition to the new standard on the Zakat base.



8. Theoretical Examples on the Effect of Transition on ZB

8.1. International Accounting Standard 28

- **Example 1:**

Establishment (A) sold and inventory to Entity (B), of which Entity (A) owns 30% of its shares. The cost of the inventory is SAR 200,000 and it was sold for SAR 300,000. The Establishment (B) also sold the inventory to the Establishment (A) and the cost of this inventory was SAR 100,000, and it was sold for SAR 120,000.

- **Required Action:**

How will the profit between associates on these transactions be dealt with in the financial statements if none of the inventory is sold at the end of the year?

Solution:

Establishment (A) to Establishment (B)

Group's profit is SAR (300 - 200)

Thousands of Riyals

Reported profit is: $100 \times 100 \div 70 = \text{SAR } 70$

100

The remaining profit will be deferred until the inventory is sold.

Establishment (B) to Establishment (A)

profit achieved by Establishment (B) is: $(120 - 100) = 20$

An amount $(20 \times 100 \div 30)$ will be deleted from the book value of the investment, i.e., SAR 6,000. The alternative is to exclude the entire profit from the Entity (B)'s profit for the period and then calculate the profit attributable to the associate.



8.1.1. Zakat Handling:

In terms of Zakat, the amount of profit disclosed in the investing company and the investee as a result of upward and downward transactions will be subject to zakat as part of the adjusted net profit for zakat purposes, and the result of the activity is not required to be modified. The same is also applicable to the loss if it resulted from these transactions.

- **Example 2:**

Entity (A) acquired on the first day of its fiscal year 35% of the equity of Establishment (B), over which it can exercise a significant influence. Establishment (A) paid SAR 475,000 for its share in Establishment (B). The book value of the identified net assets of Establishment (B) on the date of acquisition was SAR 900,000 and the fair value was SAR 1,100,000. The difference of SAR 200,000 relates to an item of property, machineries and equipment and the remaining useful life is 10 years. During the year, Establishment (B) made a profit of SAR 80,000 and paid a dividend of SAR 120,000. Establishment (B) also owns an investment in securities designated at fair value through other comprehensive income, which value is increased by SAR 20,000 during the year. For the purposes of this example, any deferred tax implications are ignored. Establishment (A) shall calculate its investment in Establishment (B) according to the equity method, as follows:

Acquisition Date of Investment in Establishment (A)	Saudi Riyals	
Book value of Establishment (A)'s share of the identifiable net assets of Establishment (B): 35% of 900,000	315,000	
Fair value of Establishment (A)'s share of the identifiable net assets of Establishment (B): 35% of (1,100,000 - 900,000)	70,000	
Goodwill of investment in Establishment (B): 475,000 - 315,000 - 70,000 riyals	90,000	
Investment Cost		475,000



Profit During the Year	Saudi Riyals	
Share of the profit disclosed by Establishment (B): 35% of 80,000	28,000	
Adjustment that reflects the effect of fair valuation 35% of (1,100,000 - 900,000 ÷ 10 years)	(7,000)	
Profit share in Establishment (B) proven in the income statement of Establishment (A)		21,000
Reassessment of assets at fair value through other comprehensive income		
Reassessment share recognized in other comprehensive income Establishment (A): 35% of 20,000		7,000
Dividends received by Establishment (A) during the year: 35% of 120,000		(42,000)
End of Fiscal Year		
Share in the book value of the Establishment (B) net assets: 315,000 + 35% (80,000 - 120,000 + 20,000)	308,000	
Establishment's share in the fair valuation of Establishment (B) specified net assets: 70.000 -7.000	63,000	
Investment goodwill in Establishment (B)	90,000	
Final balance for investment in Establishment (B)		461.000

Zakat Handling:

In terms of zakat, and assuming that these investments are qualified for deduction under Article (5) of the Executive Regulations for the Collection of Zakat, then:

- The final balance of the investment to be deducted at the end of the year: SAR 461,000.

External document

This guide has been prepared for educational purposes only, and its content may be modified at any time. It is not considered mandatory by the Authority, nor as a legal advice, and it cannot be relied and acted upon without reference to the relevant statutory provisions. Every person subject to Zakat, Tax, and Customs Laws must check their duties and obligations; they are solely responsible for the compliance with these regulations. ZATCA shall not be responsible in any way for any damages or losses incurred to the taxpayer as a result of not complying with the applicable regulations.



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