2 September 2020[1]

Issues Bulletin 2
Columnar Presentation of Takaful Funds in Takaful Entity Financial Statements

Issues Bulletin 2 is issued by the Malaysian Accounting Standards Board (MASB) as part of its Islamic Financial Reporting research. The Issues Bulletin 2 complements the MASB approved accounting standards and Issues Bulletin 1 *MFRS 17 Insurance Contracts: Definition and Scope for Takaful*. Nothing in this Issues Bulletin 2 overrides any specific MASB approved accounting standards.

1.0 Purpose and Conclusions of this Issues Bulletin

1.1 **This Issues Bulletin seeks to clarify that separate columns (including a separate column for a Takaful Fund) would be able to be presented in the primary financial statements[2] of a takaful entity, in a manner consistent with Malaysian Financial Reporting Standards (MFRSs) once MFRS 17 *Insurance Contracts* applies.[3] This Issues Bulletin also considers which columns should be presented based on the likely costs and benefits involved, consistent with the cost constraint set out in the *Conceptual Framework*.**

1.2 **This Issues Bulletin[4]:**

(a) assumes the relevance of financial statements of a takaful entity as a whole; and

(b) does not specifically address the relevance of current practices in applying particular MFRSs to particular columns.

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1 Issues Bulletin 2 was first issued in May 2020. Apart from editorial changes, namely reference to 'Issues Bulletin' instead of 'Paper' and the revised paragraph 1.6, the Issues Bulletin is updated to reflect changes in MFRS 17 as a result of the *Amendments to MFRS 17 Insurance Contracts* issued by MASB on 17 August 2020 (see paragraph C5).

2 'Primary financial statements' are: The statement(s) of financial performance, the statement of financial position, the statement of changes in equity and the statement of cash flows. 'Notes' are: Information in financial statements provided in addition to that presented in the primary financial statements. [Reference: MFRS 101.10]

3 Takaful entities are required to publish their financial statements, which must be prepared in accordance with approved accounting standards [sections 74 and 75 of the IFSA 2013]. The "approved accounting standards" are MFRSs based on the definition in section 2 of Malaysia's Financial Reporting Act 1997.

4 On the application of MFRS 17, this Issues Bulletin is intended to supersede Guidance on Special Matter No.2 *Presentation of Financial Statements for Takaful Companies* issued in 2013 by the MIA. The Guidance also covers Qard and the MASB expects to issue a separate Paper on accounting for Qard.

1.3 This Issues Bulletin considers the content in a range of MASB pronouncements, in particular:

- MFRS 101 *Presentation of Financial Statements*, [MFRS 101];
- MFRS 9 *Financial Instruments* [MFRS 9];
- MFRS 15 *Revenue from Contracts with Customers* [MFRS 15];
- MFRS 17 *Insurance Contracts* [MFRS 17]; and
- *Conceptual Framework for Financial Reporting* [*Conceptual Framework*].

1.4 This Issues Bulletin also considers the circumstances in which takaful business is conducted in Malaysia, in particular, by referencing to:

- Malaysia's *Islamic Financial Services Act 2013* (IFSA 2013);
- the Bank Negara Malaysia (BNM) *Takaful Operational Framework* (TOF) as issued on 29 June 2019; and
- the BNM *Risk-Based Capital Framework for Takaful Operators as issued on 17 December 2018*.

Terminology

1.5 For the ease of expression, reference is generally made in this Issues Bulletin to a TO [Takaful Operator] and a TF [Takaful Fund], even though takaful businesses would typically involve a TO and multiple TFs (for risk, investment and savings purposes).

1.6 This Issues Bulletin uses the term 'participant' to represent a policyholder in a conventional insurance context.

Conclusions

1.7 **This Issues Bulletin concludes the following.**

(a) A separate column for a TF can be presented in the primary financial statements of a takaful entity in a manner that is consistent with MFRSs and, depending on the circumstances, may be required in order to ensure the financial statements provide relevant information that is useful to those users with an interest in the TF's activities when they make economic decisions.

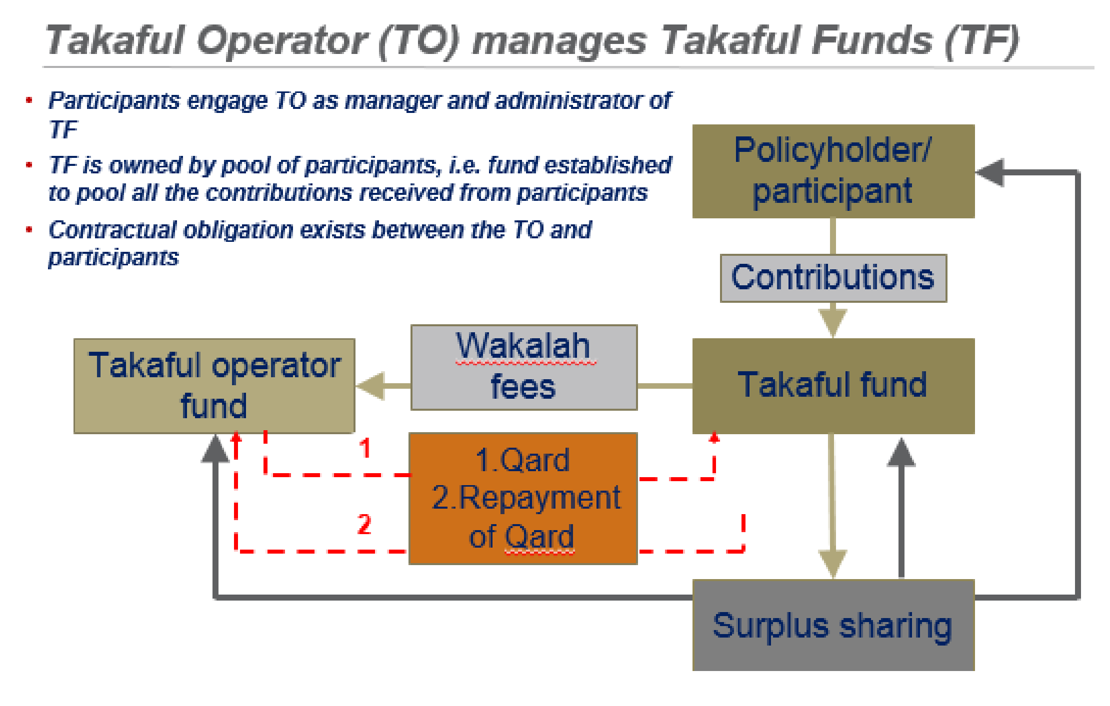
(b) Based on cost-benefit considerations, two columns should be presented – one for the TF and one for the takaful entity as a whole.

(c) The information in the TF column and the information in the takaful entity column should be determined by applying the relevant MFRSs. That is, each column would be MFRS-compliant on a stand-

alone basis. In this regard, both the TF and takaful entity would apply MFRS 17.[5]

(d) The TF column must not be more prominent than amounts explicitly required to be presented by MFRSs in the takaful entity column.

1.8 For a typical Takaful structure within a takaful entity, the diagram below represents the relationship between the TF and TO and the perspective of the TF as a reporting entity.



Note:

A TO must stand ready to rectify any deficit in a TF – this is one of the regulatory mechanisms imposed by BNM to ensure sustainability of a TF to meet participants' claims and other benefits. In the event that a TO provides *qard* to a TF, the TF is obliged to repay the TO from future surpluses in the TF.

The Shariah Advisory Council of Bank Negara Malaysia (SAC), in its 38th meeting dated 28 August 2003, 46th meeting dated 28 October 2004 and 62nd meeting dated 4 October 2006, resolved that (1) Takaful company shall be responsible for any insufficiency of the participants' risk fund by injecting fund from the shareholders fund on the basis of *qard*; and (2) The takaful company shall make an outright transfer from the shareholders fund to the participants' risk fund in the event the deficit is still persistent or due to mismanagement of the participants' risk fund.

The SAC, in its 55th meeting dated 29 December 2005, resolved that the practice of giving unconditional *hibah* in a contract of *qard* is permissible. Nevertheless, such practice shall not become a norm in order to avoid this practice from becoming an `*urf* that resembles a condition attached to the contract of *qard.*

5 See Issues Bulletin 1: MFRS 17 *Insurance Contracts*: Definition and Scope for Takaful, published by MASB at www.masb.org.my

2.0 Scope for Columnar Presentation

2.1 It is common for takaful entities in Malaysia to present separate information for TF interests and TO interests in columns, generally in the takaful entity's primary financial statements. There are many stakeholders who consider the separate presentation of columnar information is justified based, for example, on the following.

(a) The columns are required to help demonstrate that the takaful entity is conducting its business in a Shariah-compliant manner, for example, to differentiate the rights and obligations between the TO and TF.

(b) Participants are interested in information about the funds which are pooled in a TF and information about the payments made to participants who submit valid claims arising from pre-agreed circumstances. This helps to demonstrate that risk is shared among participants for the mutual benefit of participants; while the TO is a manager and administrator of the TF, managing the operational and administrative aspects of a TF.

Columns as separate reporting entities

2.2 The *Conceptual Framework for Financial Reporting* adopts the following perspective on reporting entity:

> 3.8 Financial statements provide information about transactions and other events viewed from the perspective of the reporting entity as a whole, not from the perspective of any particular group of the entity's existing or potential investors, lenders or other creditors.

2.3 Many separate legal entities are reporting entities and are required to prepare financial statements; however, the *Conceptual Framework* acknowledges that other entities, which may not be legal entities, can also be reporting entities.

> 3.10 A reporting entity is an entity that is required, or chooses, to prepare financial statements. A reporting entity can be a single entity or a portion of an entity or can comprise more than one entity. A reporting entity is not necessarily a legal entity.

2.4 The IFSA 2013 sets out key regulatory requirements for Islamic financial institutions and BNM's TOF provides additional requirements and expectations on the manner in which the activities of a TF and TO are conducted including the fiduciary duties and responsibilities of the TO.

2.5 IFSA 2013, sections 91 and 92 state that:

> 91. A licensed takaful operator shall keep any takaful fund established and maintained under section 90 separate from its shareholders' fund.
>
> 92. (1) A takaful fund established under section 90 shall be maintained and managed by a licensed takaful operator on behalf of and in the best interests of the takaful participants and the licensed takaful operator shall -
>
> (a) pay into a takaful fund all receipts in respect of takaful certificates to which the takaful fund relates and which are issued by it or under which

the takaful fund has undertaken liability, including all income of that takaful fund;

(b) maintain at all times assets in a takaful fund of a value equivalent to or higher than the liabilities of that takaful fund;

(c) apply the assets of a takaful fund only to meet the liabilities and expenses properly incurred by that takaful fund; and

(d) comply with such other requirements as may be specified by the Bank under paragraph 57(2)(g) including requirements on the types of assets to be, or not to be included, as assets of a takaful fund.

(2) For the purposes of subsection (1), the Bank may specify what constitutes “receipts”, “income”, “liabilities” or “expenses” of the takaful fund which are attributable to the business to which a takaful fund or takaful certificate relates, and the manner to determine or value the receipts, income, assets, liabilities or expenses.

(3) Unless the Bank otherwise approves, a licensed takaful operator shall maintain a takaful fund established under section 90 so long as it is under liability in respect of any takaful certificate or takaful claim relating to that takaful fund.

2.6 Although a TF is not a separate legal entity from the TO, sections 91 and 92 of the IFSA 2013 create distinct rights and obligations in relation to the TF and require that the TF be managed in a manner that preserves the interests of takaful participants at all times.

2.7 In addition, paragraphs 9.1 and 9.2 of the TOF outline that TFs are established by the TO, but the TFs collectively belong to participants.

S 9.1 Section 91 of the IFSA imposes an obligation on a licensed takaful operator to establish general takaful funds or family takaful funds separate from its shareholders fund

S 9.2 As takaful funds are owned by takaful participants (footnote 2), section 92 of the IFSA also imposes an obligation for a licensed takaful operator to ensure that the funds are established and managed in a manner that preserve the interest of the takaful participants at all times.

Footnote 2: Under tabarru`, participant risk fund is collectively owned by the pool of takaful participants as per the SAC ruling.

2.8 Paragraphs 1.1, 8.1 and 8.2 of TOF further outline key aspects of the TO’s role and responsibilities:

1.1 A licensed takaful operator carrying on takaful business has the duty to manage the takaful operations in accordance with Shariah and in the best interest of the takaful participants. This includes operating the business in a sound and prudent manner.

S 8.1 The board [of the TO[6]] has the overall oversight over the effective management of takaful operations that support a licensed takaful operator’s business and risk strategies. In fulfilling this role, the board must approve an operational framework governing the management of takaful operations that complies with Shariah and promotes sustainable takaful operations.

6 Added for clarity.

S 8.2 In relation to paragraph S 8.1, the senior management [of the TO[7]] must ensure that the operational framework is commensurate with the nature and complexity of the takaful business and considers the types of funds being managed and relevant Shariah contracts adopted in managing the takaful business. In this regard, the operational framework must include, at the minimum, policies and procedures on –

(a) application of Shariah contracts;

(b) establishment and maintenance of takaful funds and shareholders fund, including, where applicable, establishment of additional takaful funds or consolidation of additional PRF(s);

(c) product structuring;

(d) management of underwriting;

(e) management of retakaful;

(f) management of investments;

(g) management of claims;

(h) remuneration for management of takaful funds;

(i) management of operating costs;

(j) management of surplus in PRF; and

(k) management of deficiency and loss rectification.

2.9 In this regard, the facts and circumstances considered above establish that:

(a) the TF is a 'portion of an entity' (CF3.10) with boundaries that do 'not contain an arbitrary or incomplete set of economic activities' and 'results in neutral information' (CF3.14); and

(b) the TO is the manager and administrator of the TF.

Thus, the TF could be a reporting entity that compiles its own stand-alone financial statements applying MFRSs. However, in the context of the financial statements of the takaful entity as a whole, information on the TF would be additional disclosure, subject to the presentation principles in MFRS 101.

Presentation principles under MFRSs

2.10 MFRS 101.15, 31, 55 and 85 refer to the conditions under which additional disclosures are relevant (emphasis added):

15 Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework. The application of MFRSs, **with additional disclosure when necessary**, is presumed to result in financial statements that achieve a fair presentation.

31 … An entity shall also consider whether to **provide additional disclosures when compliance with the specific requirements in MFRS is insufficient** to enable users of financial statements to understand the

7 Added for clarity.

impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

55 An entity shall **present additional line items** (including by disaggregating the line items listed in paragraph 54), headings and subtotals in the **statement of financial position when such presentation is relevant to an understanding of the entity's financial position**.

85 An entity shall **present additional line items** (including by disaggregating the line items listed in paragraph 82), headings and subtotals in the **statement(s) presenting profit or loss and other comprehensive income when such presentation is relevant to an understanding of the entity's financial performance**.

2.11 Additional information can be presented in columns under MFRSs. MFRS 101.52 refers to columns potentially being used to present information if management judges this to be the best way to do so. MFRSs do not restrict columnar presentation of this type.

51 An entity shall clearly identify each financial statement and the notes. In addition, an entity shall display the following information prominently, and repeat it when necessary for the information presented to be understandable:

(a) the name of the reporting entity or other means of identification, and any change in that information from the end of the preceding reporting period;

(b) whether the financial statements are of an individual entity or a group of entities;

(c) the date of the end of the reporting period or the period covered by the set of financial statements or notes;

(d) the presentation currency, as defined in MFRS 121; and

(e) the level of rounding used in presenting amounts in the financial statements.

52 An entity meets the requirements in paragraph 51 by presenting appropriate headings for pages, statements, notes, columns and the like. Judgement is required in determining the best way of presenting such information. For example, when an entity presents the financial statements electronically, separate pages are not always used; an entity then presents the above items to ensure that the information included in the financial statements can be understood.

Columns provide relevant information to users

2.12 Columnar presentation is common for takaful entities in Malaysia whereby they present separate information for TF interests and TO interests in columns, generally in the primary financial statements.

2.13 Many stakeholders consider the separate presentation of information is justified based, for example, on the following.

(a) The columns are needed to help demonstrate that the takaful entity is conducting its business in a Shariah-compliant manner, for example, to show the different rights and obligations relating to the TO and TF.

(b) A TF column helps enable the risk sharing concept for the mutual benefit of participants to be demonstrated, while the TO is manager and administrator of the TF, and manages the operational and administrative aspects of takaful contracts.

2.14 The *Conceptual Framework* identifies the 'primary users' of financial statements as being existing and potential investors, lenders or other creditors [CF1.3 to 1.5].

2.15 In the case of a takaful entity, the primary users would presumably include existing and potential investors and lenders or other creditors of the TO who would have a focus on the financial position and performance of the takaful entity as a whole. This is because all of the assets and liabilities of the takaful entity, whether they be within the TF or the TO, are relevant to generating a return for the takaful entity.

2.16 In the case of a TF, the primary users would presumably include existing and potential participants (or their representatives) in the TF, regulators and investors. In order to address those interested in Shariah compliance for the takaful entity as whole, it is necessary to show the segregation of the TF interests within the entity.

IASB proposal on the use of columns

2.17 The IASB in December 2019 issued Exposure Draft ED/2019/7 *General Presentation and Disclosures* [ED/2019/7] proposing improvements to the way information is communicated in the financial statements, with a focus on financial performance. In particular, paragraph 101, includes the following proposal.

> 101 An entity shall not use columns to present management performance measures in the statement(s) of financial performance.

There are no other proposed prohibitions in ED/2019/7 on the presentation of columnar information in the financial statements.

2.18 The types of columnar information presented in respect of takaful entities does not fall within the description of 'management performance measures' in ED/2019/7, paragraph 103. An example of a management performance measure would be an amount of 'underlying profit' as defined by management (not MFRS). In contrast, the columnar information discussed in this Issues Bulletin is prepared in accordance with MFRS. ED/2019/7, paragraphs 103 and 110 say:

> 103 Management performance measures are subtotals of income and expenses that (see paragraphs B76–B81):
>
> (a) are used in public communications outside financial statements;
>
> (b) complement totals or subtotals specified by IFRS Standards; and
>
> (c) communicate to users of financial statements management's view of an aspect of an entity's financial performance.

> 110 An entity shall not use columns to present management performance measures in the statement(s) of financial performance

2.19 The fact that the IASB sees a need to propose a specific prohibition for the columnar presentation of management performance measures strongly implies that, in general, it is acceptable to present additional information in IFRS-compliant financial statements. Otherwise, the specific prohibition would not be necessary.

IFRS Interpretations Committee (IFRIC)

2.20 The IFRS Interpretations Committee (IFRIC) at its May 2014 meeting considered a request[8] to clarify the application of some of the presentation requirements in IAS 1 *Presentation of Financial Statements*.[9]

2.21 The IFRIC decided not to propose an Interpretation or an amendment to a Standard and, consequently, not to add this issue to its agenda on the basis that it would be beneficial if the IASB's Disclosure Initiative considered what guidance should be given for the presentation of information beyond what is required in accordance with IFRS.

2.22 The IFRIC also made a number of observations.

(a) A complete set of financial statements is comprised of items recognised and measured in accordance with IFRS.

(b) IAS 1 addresses the overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content. It also noted that while IAS 1 does permit flexibility in presentation, it also includes various principles for the presentation and content of financial statements as well as more detailed requirements. These principles and more detailed requirements are intended to limit the flexibility such that financial statements present information that is relevant, reliable, comparable and understandable.

(c) The Interpretations Committee observed that securities regulators, as well as some members of the Interpretations Committee, were concerned about the presentation of information in the financial statements that is not determined in accordance with IFRS. They were particularly concerned when such information is presented in the primary statements.

2.23 Consistent with the IFRIC's discussion, it seems reasonable to conclude that, any additional information provided in MFRSs-compliant financial statements, ideally, would be expected to be prepared using MFRSs. That is, the additional information, on a stand-alone basis, should be MFRSs-compliant. IFRIC's

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8 The submitter expressed a concern that the absence of definitions in IAS 1 and the lack of implementation guidance give significant flexibility that may impair the comparability and understandability of financial statements. One of the examples provided by the submitter was the presentation of additional columns in the financial statements.

9 As reported in *IFRIC Update* May 2014.

discussion is consistent with the sentiment in MFRS 101.55A(a) and 85A(a), in respect of additional line items being presented in statements of financial position and statement(s) presenting profit or loss and other comprehensive income. Although MFRS 101.55A and 85A do not relate specifically to additional columnar information, they could be regarded as applying by analogy.

2.24 In arriving at the conclusion that the respective columns presented are MFRSs compliant, this Issues Bulletin considered the IASB TRG discussion at its February 2018 meeting that the lowest level of the unit of account used in IFRS 17 is a contract, and that contracts are normally designed in a way that reflects their substance. An implication of this TRG discussion is that a contract as a whole should be accounted for using MFRS 17 – that is, it would be inconsistent with MFRS 17 to separately account for the disaggregated components of a contract.

2.25 Under the typical takaful structure, this Issues Bulletin takes the view that in accordance with the TOF, there is only one contract between the TF and the participants. The TF receives the gross contribution from the participant and the TF accepts insurance risk from a participant. Consequently, accounting for the takaful contract in the TF is consistent with the notion of a contract being the lowest level unit of account under MFRS 17.

Prominence

2.26 There is no specific restriction on the level of prominence given to any additional columnar information included in an entity's financial statements (for example, the financial statements of a takaful entity). However, it seems reasonable to infer from the requirements in MFRS 101.55A(d) and 85A(d) that there is a restriction.

2.27 MFRS 101.55A(d) and 85A(d) relate specifically to additional line items in presented in statements of financial position and in statement(s) of profit or loss and other comprehensive income and require that any form of additional information in an entity's financial statements should not be more prominent than the information required by MFRS Standards. Although MFRS 101.55A and 85A do not relate specifically to additional columnar information, they could be regarded as applying by analogy. That is, because the financial statements are those of the takaful entity as a whole and the TF column relates to a sub-set of information about the entity, it must not be more prominent than amounts explicitly required to be presented / disclosed by MFRSs in respect of the takaful entity as a whole.

Summary analysis

2.28 There is no specific restriction on presentation using columns in MFRSs. Although ED/2019/7 proposes a limitation on columnar presentations, that limitation is not relevant to the issues being addressed in this Issues Bulletin. Accordingly, separate columns for a TF and a TO can be presented in the primary financial statements of a takaful entity, consistent with MFRSs.

2.29 Some stakeholders consider additional columnar information about a TO and TF to be important for users to understand a takaful entity's financial statements. Arguably, this means the additional information about the interests of the TF would be required to be presented in a takaful entity's financial statements in order to comply with MFRSs, consistent with the spirit of MFRS 101.55 and 85.

2.30 The information presented in the primary financial statements of a takaful entity, whether for a TF column on a stand-alone basis or for the takaful entity (or combined / total) column, ideally, would be determined in accordance with MFRSs and be a faithful representation.

2.31 Given that the financial statements are for the takaful entity as a whole,[10] the information presented in the TF column would be no more prominent than amounts explicitly required to be presented in a takaful entity's financial statements by MFRSs [namely, the takaful entity (or combined / total) column].

3.0 How many columns should be presented?

How many columns?

Options considered

3.1 This Issues Bulletin explores three possible options as follows:

(a) Option 1: Three columns – (1) TF; (2) TO (and adjustments); and (3) takaful entity

(b) Option 2: Three columns – (1) TF; (2) TO and (3) takaful entity

(c) Option 3: Two columns – (1) TF; and (2) takaful entity.

3.2 Due to the many transactions between a TF and TO, in aggregating to a takaful entity column, there are adjustments to be made. Some stakeholders consider that, when columns are presented in the primary financial statements, a user should be able to aggregate to the takaful entity column and, therefore, the adjustments would need to be included in one of the columns or in a separate column.

3.3 The options considered are illustrated in Appendix B.

MFRS relevant to each column

3.4 This Issues Bulletin does not address the detail around applying MFRS 17 to takaful contracts or the way in which other MFRSs would apply to the TF and TO columns if they were separately presented; however, the following observations are made to facilitate the discussion.

(a) A TF that pools risks of the participants would apply MFRS 17 in view of the transfer of insurance risk between individual participants and the TF

10 Takaful entities are required to publish their financial statements, which must be prepared in accordance with approved accounting standards (MFRSs) [sections 74 and 75 of the IFSA 2013].

under takaful contracts. In the context of a stand-alone TF, there is no contractual service margin (CSM). This is on the basis that, 100% of the surplus due to participants, determined from the TF perspective, is shared among those participants and not among other stakeholders, consistent with the IFRS 17 TRG discussion.[11]

(b) At the takaful entity level, there would typically be a CSM because the entity as a whole would generate profit from conducting the takaful business.

(c) The TO, as a manager and administrator of the TF receives a fixed fee (wakalah fee) and/or pre-agreed share of surplus for managing the TF's operations and would need to apply MFRS specific to the TO itself which, depending on the facts and circumstances, would include MFRS 15 to account for its fees.

3.5 Note that for all three options identified above, there would be a need to apply MFRS 17 from two perspectives: (1) the TF perspective; and (2) the takaful entity perspective. These two perspectives are illustrated in a simplified manner in Appendix A and arise because:

(a) at the TF level, there is no CSM because the TF does not seek to profit from its participants; and

(b) at the takaful entity level, once all the activities conducted by a TO that are associated with managing and administering the TF are included, there would ordinarily be a CSM because the takaful entity aims to profit from participants in conducting its takaful business.

Because this applies under all three options, it is not analysed in the cost-benefit considerations below, which focuses on differences between the options.

Cost-benefit considerations

3.6 Each additional column presented in a takaful entity's financial statements has the potential to provide benefits in the form of useful information for users and each additional column also involves preparation and audit costs and costs for users seeking to understand the information. Accordingly, it is important to consider the relative costs and benefits of the options outlined in paragraph 3.1.

11 The IFRS 17 TRG noted that, for contracts that share in 100% of the return on a pool of underlying items consisting of the insurance contracts, the CSM will be nil. This is recorded in the IFRS 17 TRG September 2018 meeting summary, paragraph 40(c), and is based on discussion of Agenda paper 10 *Annual cohorts for contracts that share in the return of a specified pool of underlying items*. Although takaful contracts might specify that the TF shares in, for example, 50% of surpluses, while the TO receives the other 50%, the TO's share is regarded as a fee (an expense) from the perspective of the TF. That is, the surplus in the context of the TF as a stand-alone entity is determined after deducting the TO's fee. Participants share in 100% of this reduced surplus.

3.7 The *Conceptual Framework* includes guidance on assessing the relative costs and benefits of useful financial reporting, including the following (emphasis added).

> 2.39 Cost is a pervasive constraint on the information that can be provided by financial reporting. <u>Reporting financial information imposes costs, and it is important that those costs are justified by the benefits of reporting that information</u>. …
>
> 2.41 Reporting financial information that is relevant and faithfully represents what it purports to represent helps users to make decisions with more confidence. … However, <u>it is not possible for general purpose financial reports to provide all the information that every user finds relevant</u>.
>
> 2.42 <u>In applying the cost constraint, the Board[12] assesses whether the benefits of reporting particular information are likely to justify the costs incurred to provide and use that information</u>. …
>
> 2.43 Because of the inherent subjectivity, different individuals' assessments of the costs and benefits of reporting particular items of financial information will vary. <u>Therefore, the Board seeks to consider costs and benefits in relation to financial reporting generally, and not just in relation to individual reporting entities</u>. …

Option 1: Three columns – (1) TF; (2) TO (and adjustments); and (3) takaful entity

3.8 By presenting 'other adjustments' in the TO column, Option 1 addresses the concern of some stakeholders that the numbers in each column should aggregate to the takaful entity column.

3.9 Although it would be feasible to have a stand-alone TO column, the existing and potential investors and lenders or other creditors of a TO will typically be interested in the information for the takaful entity as a whole in order to have a complete picture of the entity's activities. Accordingly, the extent to which a TO column would provide useful information to its primary users is not clear.

3.10 There are also likely to be substantive costs involved in presenting a TO column because the TO:

(a) on a stand-alone basis, would need to apply MFRS specific to the TO itself which, depending on the facts and circumstances, would include MFRS 15 in accounting for the various fees it receives in its role as manager and administrator (refer to Appendix C);

(b) as part of the takaful entity as a whole, would need to apply MFRS 17 because it is engaged in issuing insurance contracts.

Therefore, if a TO column were presented, information about the TO would need to be reported in two different ways.

12 The Board referenced here is the International Accounting Standards Board; however, the same applies to the assessments that the Malaysian Accounting Standards Board must make.

Option 2: Three columns – (1) TF; (2) TO and (3) takaful entity

3.11 Option 2 mirrors the format of the current Malaysian takaful entity's financial statements under MFRS 4. Although the columns do not aggregate to the takaful entity column, it may be appropriate for entities applying this approach to include a footnote that explains why the columns do not aggregate.

3.12 Option 2 raises the same cost-benefit concerns in respect of having a TO column as noted in respect of Option 1.

Option 3: Two columns – (1) TF; and (2) takaful entity

3.13 Option 3 is supported by some stakeholders who see the TF and takaful entity columns as the essential information that needs to be in the primary financial statements. They take the view that:

(a) the TO, in isolation, is only a manager and administrator [TOF paragraph 1.3], with few specific items needing to be presented in the primary financial statements such as wakalah fees and management expenses;

(b) the key reason for presenting a separate TF column is to reflect explicitly that a TO is managing the TF in the best interests of participants and separately from the shareholders' fund, [IFSA 2013 section 92]; and

(c) the primary focus of a takaful entity's existing and potential investors and lenders or other creditors is the takaful entity information, with only a secondary interest in the separate TO information.

3.14 Although having only two columns does not facilitate an aggregation across the financial statements, each key stakeholder group [(1) existing and potential participants (or their representatives)[13]; and (2) existing and potential investors and lenders or other creditors] would have MFRS-compliant financial statements that focus on their particular interests. Each group of primary users can focus on the column of information most relevant to them, rather than reconciling the two columns.

3.15 A key advantage of Option 3 is that it would be far less costly to apply than Option 1 or Option 2 because, if there is a TO column, it would need to be prepared based on applying MFRS specific to the TO itself which, depending on the facts and circumstances, would include MFRS 15. Any potential shortfall in information about the TO could be included in notes if necessary.

13 In particular, the TF column helps demonstrate that the takaful entity is conducting its business in a Shariah-compliant manner, for example, to differentiate the rights and obligations between the TO and TF.

Appendix A
Illustration

The illustration is intended to show the interactions between the columns and does not purport to show what is expected to be presented in actual financial statements as the illustration is based on highly simplified fact patterns, which does not include all the necessary cash flows items that typically apply to takaful contracts.

Simplified fact patterns:

1 *One single family takaful certificate with one-year coverage period issued on 1 January 2019.*

2 *Apply general measurement model, even though it is a one-year coverage period.*

Expected results on initial recognition date are as follows:

	Takaful Operator Fund (TO)	Takaful Participants Fund (TF)		Combined [Company]
	Shareholder's Fund	**Participant Risk Fund**	**Participant Investment Account**	**Total**
Expected contributions	-	-	100,000	100,000
Expected wakalah fees	50,000	-	(50,000)	-
Expected tabarru charges	-	40,000	(40,000)	-
Expected fund management charges	-	-	-	-
Expected claims	-	(10,000)	-	(10,000)
Expected Takaful benefits payable in the form of hibah	(5,000)	-	-	(5,000)
Expected acquisition expenses	(20,000)	-	-	(20,000)
Expected maintenance expenses	(25,000)	-	-	(25,000)
Expected other expenses (non-attributable)	(1,000)	-	-	(1,000)
Expected surplus to PIA	-	(15,000)	15,000	-
Expected surplus to SHF	15,000	(15,000)	-	-
Expected deficit support from SHF	-	-	-	-
Expected RA	-	-	-	-
Expected maturity payment from PIA to customer	-	-	(25,000)	(25,000)
Net	**14,000**	**-**	**-**	**14,000**

3 *Actual results are equal to expected results.*

4 *As the whole takaful certificate is considered as the lowest unit of account, the certificate only has 1 CSM.*

5 *Surplus outgo to the Participant Investment Account and Shareholder's Fund is treated as fulfilment cash flows of the Participant Risk Fund.*

6 *The non-distinct investment component amounts to 30,000 (25,000 relates to maturity payment from PIA to the customer and the remaining 5,000 from the claims payment to the customer) which is determined based on all circumstances criteria.*

	COLUMN 1	COLUMN 2
Income statement	**TF**	**Company**
Revenue:		
Takaful revenue:		
Expected wakalah fees	50,000	-
Expected claims	5,000	5,000
Expected takaful benefits payable in the form of hibah	-	5,000
Expected surplus to PIA	-	-
Expected surplus to SHF	15,000	-
Expected maintenance expenses	-	25,000
Recovery of acquisition expenses	-	20,000
Release of CSM	-	15,000
	70,000	**70,000**
Service revenue:		
Wakalah fees	-	-
Performance fees - surplus	-	-
	-	**-**
Total revenue	**70,000**	**70,000**
Operating expenses:		
Takaful service expenses:		
Actual wakalah fees	(50,000)	-
Actual Tabarru charges	-	-
Actual claims	(5,000)	(5,000)
Actual takaful benefits payable in the form of hibah	-	(5,000)
Actual surplus to PIA	-	-
Actual surplus to SHF	(15,000)	-
Amortization of acquisition expenses	-	(20,000)
Actual maintenance expenses	-	(25,000)
	(70,000)	**(55,000)**
Service expenses:		
Management expenses	-	-
Commission expenses	-	-
	-	**-**
Total operating expenses	**(70,000)**	**(55,000)**
Operating results	**-**	**15,000**
Other expenses	**-**	**(1,000)**
Profit before taxation and zakat		**14,000**

Appendix B
Illustration – Detailed columns

The illustration is intended to show the interactions between the columns and does not purport to show what is expected to be presented in actual financial statements as the illustration is based on highly simplified fact patterns.

				COLUMN 1			COLUMN 2
	Takaful Participants Fund (TF)				Takaful Operator	Adjustments	Company
Income statement	Participant Risk Fund	Participant Investment Account	Adjustments	Total	Operator Fund	Adjustments	Combined
	A	B	C	D=A+B+C	E	F	G=D+E+F
Revenue:							
Takaful revenue:							
Expected wakalah fees	-	50,000	-	50,000	-	(50,000)	-
Expected Tabarru charges	-	40,000	(40,000)	-	-	-	-
Expected claims	10,000	-	(5,000)	5,000	-	-	5,000
Expected takaful benefits payable in the form of hibah	-	-	-	-	-	5,000	5,000
Expected surplus to PIA	15,000	-	(15,000)	-	-	-	-
Expected surplus to SHF	15,000	-	-	15,000	-	(15,000)	-
Expected deficit support from SHF	-	-	-	-	-	-	-
Expected maintenance expenses	-	-	-	-	-	25,000	25,000
Recovery of acquisition expenses	-	-	-	-	-	20,000	20,000
Release of risk adjustments	-	-	-	-	-	-	-
Release of CSM	-	-	-	-	-	15,000	15,000
	40,000	**90,000**	**(60,000)**	**70,000**	**-**	**-**	**70,000**
Service revenue:							
Wakalah fees	-	-	-	-	50,000	(50,000)	-
Performance fees - surplus	-	-	-	-	15,000	(15,000)	-
	-	**-**	**-**	**-**	**65,000**	**(65,000)**	**-**
Total revenue	**40,000**	**90,000**	**(60,000)**	**70,000**	**65,000**	**(65,000)**	**70,000**
Operating expenses:							
Takaful service expenses:							
Actual wakalah fees	-	(50,000)	-	(50,000)	-	50,000	-
Actual Tabarru charges	-	(40,000)	40,000	-	-	-	-
Actual claims	(10,000)	-	5,000	(5,000)	-	-	(5,000)
Actual takaful benefits payable in the form of hibah	-	-	-	-	-	(5,000)	(5,000)
Actual surplus to PIA	(15,000)	-	15,000	-	-	-	-
Actual surplus to SHF	(15,000)	-	-	(15,000)	-	15,000	-
Actual deficit support from SHF	-	-	-	-	-	-	-
Actual maintenance expenses	-	-	-	-	-	(25,000)	(25,000)
Amortization of acquisition expenses	-	-	-	-	-	(20,000)	(20,000)
Losses on onerous contracts	-	-	-	-	-	-	-
Reversal of losses on onerous contracts	-	-	-	-	-	-	-
	(40,000)	**(90,000)**	**60,000**	**(70,000)**	**-**	**15,000**	**(55,000)**
Service expenses:							
Management expenses	-	-	-	-	(25,000)	25,000	-
Commission expenses	-	-	-	-	(20,000)	20,000	-
Hibah expenses	-	-	-	-	(5,000)	5,000	-
	-	**-**	**-**	**-**	**(50,000)**	**50,000**	**-**
Total operating expenses	**(40,000)**	**(90,000)**	**60,000**	**(70,000)**	**(50,000)**	**65,000**	**(55,000)**
Operating results	**-**	**-**	**-**	**-**	**15,000**	**-**	**15,000**
Takaful finance results:							
Investment income	-	-	-	-	-	-	-
Takaful finance expenses	-	-	-	-	-	-	-
Takaful finance results	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Other expenses	-	-	-	-	(1,000)	-	(1,000)
Profit before zakat and taxation	**-**	**-**	**-**	**-**	**14,000**	**-**	**14,000**
Zakat	-	-	-	-	-	-	-
Taxation	-	-	-	-	-	-	-
Net profit for the year	**-**	**-**	**-**	**-**	**14,000**	**-**	**14,000**

Appendix C

MFRS applicable to a TO

C.1 This Issues Bulletin does not recommend the reporting of stand-alone information for a TO based on cost-benefit considerations. However, if a TO were to report on a stand-alone basis, this Appendix concludes that MFRS 15 would probably apply.

C.2 Even though the 'insurance contract' definition is the same in MFRS 4 and MFRS 17, there could be different accounting under each of these Standards due to the MFRS 17 requirements relating to the application of MFRS 15 (which are not in MFRS 4).

Contract cash flows – unit of account

C.3 Discussion at the February 2018 meeting of the IASB's IFRS 17 TRG[14] established that, effectively, the lowest level of the unit of account used in IFRS 17 is a contract, and that contracts are normally designed in a way that reflects their substance. That is, contracts typically[15] would not be split into more granular units of account for financial reporting purposes.

C.4 Accordingly, the application of insurance contract accounting for reporting on each of the TO and TF on a stand-alone basis might be acceptable under MFRS 4, but typically would not be acceptable under MFRS 17 assuming the information for each of the TO and TF is MFRS-compliant on a stand-alone basis.

Services provided by TO – MFRS 15 and MFRS 17

C.5 The TO can be viewed as a manager and administrator that would recognise revenue under MFRS 15 as it satisfies its performance obligations. MFRS 17.8 and 12 say (emphasis added):

> 8 Some contracts meet the definition of an insurance contract but have as their primary purpose the provision of services for a fixed fee. An entity may choose to apply MFRS 15 instead of MFRS 17 to such contracts that it issues if, and only if, specified conditions are met. The entity may make that choice contract by contract, but the choice for each contract is irrevocable. The conditions are:
>
> (a) the entity does not reflect an assessment of the risk associated with an individual customer in setting the price of the contract with that customer;
>
> (b) the contract compensates the customer by providing services, rather than by making cash payments to the customer; and

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14 IASB Transitional Resource Group TRG for IFRS 17 (TRG), *Separation of insurance components of a single insurance contract,* February 2018.

15 An example of when it might be appropriate to override the presumption that a single contract is the lowest unit of account is when more than one type of insurance cover is included in one legal contract solely for the administrative convenience of the policyholder and the price is simply the aggregate of the standalone prices for the different insurance covers provided [IFRS 17 TRG February 2018 meeting summary, paragraph 8(b)].

(c) the *insurance risk* transferred by the contract arises primarily from the customer's use of services rather than from uncertainty over the cost of those services.

12 After applying paragraph 11 to separate any cash flows related to embedded derivatives and distinct investment components, an entity shall separate from the host insurance contract any promise to transfer to a policyholder distinct goods or services other than insurance contract services, applying paragraph 7 of MFRS 15. The entity shall account for such promises applying IFRS 15. In applying paragraph 7 of MFRS 15 to separate the promise, the entity shall apply paragraphs B33–B35 of MFRS 17 and, on initial recognition, shall:

(a) apply MFRS 15 to attribute the cash inflows between the insurance component and any promises to provide distinct goods or services other than insurance contract services; and

(b) attribute the cash outflows between the insurance component and any promised goods or services other than insurance contracts services, accounted for applying IFRS 15 so that:

(i) cash outflows that relate directly to each component are attributed to that component; and

(ii) any remaining cash outflows are attributed on a systematic and rational basis, reflecting the cash outflows the entity would expect to arise if that component were a separate contract.

MFRS 4 does not include the choice as per MFRS 17.8 or the requirements in MFRS 17.12.

C.6 There may be some circumstances in which a TO (on a stand-alone basis) can be regarded as primarily providing services for fixed fees, and could choose to apply MFRS 15, based on MFRS 17.8. However, a TO would probably not typically meet all the conditions in MFRS 17.8, particularly when a TO's compensation includes a significant level of profit share (rather than fixed fees) as compensation for services provided.

C.7 Alternatively, a TO can be regarded as being a manager and administrator in the context of MFRS 15, by virtue of MFRS 17.12. Although the services provided by a TO relate to insurance contracts, the TO is not acting in the capacity of a principal in a takaful contract. In the context of MFRS 17, the TF is acting in the capacity of a principal in a takaful contract, while the TO provides distinct services, such as managing the underwriting process, managing the claims handling process and arranging retakaful coverage.

C.8 Accordingly, from the perspective of the information reported for the TO, the services provided by a TO typically would be regarded as distinct goods or non-insurance services in the context of MFRS 17.12, to be accounted for under MFRS 15.

C.9 Note, however, that from the perspective of the takaful entity as a whole, the combined TF and TO activities would constitute insurance services to be accounted for under MFRS 17.