20 August 2021#

Issues Bulletin 3
Reporting Qard in the Takaful Fund Column within Takaful Entity Financial Statements

Issues Bulletin 3*, issued by Malaysian Accounting Standards Board (MASB) complements the MASB approved accounting standards as well as Issues Bulletin 1 *MFRS 17 Insurance Contracts: Definition and Scope for Takaful* and Issues Bulletin 2 *Columnar Presentation of Takaful Funds in Takaful Entity Financial Statements*. Nothing in this Issues Bulletin overrides any specific MASB approved accounting standards or any requirement in a Standard.

1.0 Background

Purpose

1.1 Qard arises in a wide range of circumstances, including in respect of investment certificates, benevolent loans, short term loans, credit cards and charge cards and is used in liquidity management by Islamic financial institutions.[1] It follows that accounting for qard would depend on the facts and circumstances of each case.

1.2 The purpose of this Issues Bulletin is to address qard in the context of a Takaful Operator's (TO's) obligation to contribute qard to a Takaful Fund (TF) in order to rectify a deficit under Section 95 of the *Islamic Financial Services Act 2013* (IFSA) in light of:

(a) the impending transition from MFRS 4 *Insurance Contracts* to MFRS 17 *Insurance Contracts*,

(b) the columnar presentation of separate MFRS compliant financial information for a Takaful Fund (TF) and a Takaful Operator (TO), and

(c) the consequential effects on the application of other standards, including MFRS 9 *Financial Instruments*.

The conclusions identified in this Issues Bulletin are intended to apply in this context and may not be more broadly applicable to qard that arises in other circumstances.

Issues Bulletin 3 was issued in June 2021 and updated in August 2021 for footnote 12 of paragraph 2.6 to reflect the publication of the Shariah Advisory Council of Bank Negara Malaysia (SAC) resolution on the application of time value of money for qard issued in July 2021.

* This subject matter was undertaken as part of the Islamic financial reporting research work, specifically on the application of MFRS 17 *Insurance Contracts* to Takaful.

1 Shariah Resolutions in Islamic Finance, Second edition, BNM, page 47.

Columnar presentation and the IFSA

1.3 The MASB has decided that for the purposes of reporting in Malaysia, MFRS-compliant financial information should be presented separately (typically in columns) for a TF and for the takaful entity.

1.4 The MASB has also concluded that:

(a) the TF should apply MFRS 17 on the basis that the TF is the party that accepts insurance risk from takaful participants and compensates them if they incur an insured loss, consistent with the definition of 'insurance contract' under MFRS 17;

(b) the TO is a service provider to the TF and, if it were to prepare financial statements on a stand-alone basis, should not apply MFRS 17; and

(c) the takaful entity as whole (consolidating the TF and TO columns) should apply MFRS 17.

1.5 Depending on the accounting applied to qard, the process of consolidating the TF and TO accounts might involve one or more adjustments. For example, if a qard asset in the TO financial statements is equivalent to the qard liability in the TF financial statements, the elimination would be one simple consolidation adjustment. However, if a qard asset in the TO financial statements is not equivalent to the qard liability in the TF financial statements, the consolidation adjustment process would also involve adjusting current and retained earnings in order to complete the elimination.[2]

1.6 This Issues Bulletin refers to TF financial information and does not address whether MFRS-compliant financial information for each TF is presented separately or an aggregate of all TFs is presented. For the sake of simplicity in discussing the issues, this Issues Bulletin addresses the simplest case. It does not purport to show the level of detail that would typically exist with, for example a separate risk fund and separate investment fund.

1.7 In considering these issues, this Issues Bulletin attempts to balance legal and regulatory compliance[3] and also promote reporting consistent with MFRS pronouncements.

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[2] For example, if the carrying amount of qard in the TO column applying MFRS 9 (see Annex, Section B) is MYR1,900,000 and the carrying amount in the TF column applying MFRS 17 (see section 3) is MYR2,000,000, the eliminating adjustments on consolidation of the takaful entity could be as follows:

	Debit	Credit
TF qard payable	MYR2,000,000	
TO qard receivable		MYR1,900,000
TO retained earnings		MYR70,000
TO current earnings		MYR30,000

[3] Refer policy documents issued by Bank Negara Malaysia on *Qard* and *Takaful Operational Framework* as well as relevant Shariah Advisory Council resolutions.

Terms of qard[4]

1.8 In the event that a TF has a deficiency, under section 95 of the IFSA, the TO must provide qard or other forms of financial support to the TF from the shareholders' funds. IFSA, section 95, says the amount of qard and the terms and conditions on which it is provided may be specified by Bank Negara Malaysia. Accordingly, a TO:

(a) stands ready to provide qard in the event there is a deficit in a TF; and

(b) would contribute qard by paying cash to the TF when a deficit arises in a TF.

1.9 A deficiency in this context may arise from either liquidity considerations, or accounting or regulatory considerations. The underlying cause may be either timing of cash flows or the inability of the in-force book to generate surpluses over its expected life span[5]. These factors may in turn be reflected in accounting or measurement although the timing of such recognition may differ.

1.10 There is a range of possible terms that might be relevant when qard is contributed to a TF and the BNM policy document *Qard* (February 2018) says:

> S 14.10 The money borrowed under the *qard* contract must be repaid according to the agreed term of the *qard* contract or, in the event that there is no such term, at the request of the lender.
>
> S 14.11 In the event the contracting parties agree that the money borrowed under the *qard* contract is to be repaid in a different currency, such repayment must be based on the prevailing exchange rate on the payment date or any rate agreed by the parties on the payment date.
>
> G 14.12 In the event that the borrower fails to repay the money, the borrower may be subject to late payment charges as determined by the relevant authorities.

Accordingly, in the context of the BNM policy document *Qard*, it is intended that the amount contributed by way of qard be repaid and it is not a benevolent loan or a donation.

1.11 To the extent the relevant deficit in the TF endures, the qard may not be repaid. This would be the case even if the originally agreed term for qard has expired or when there is no agreed term. The repayment period would be dependent on a TF having sufficient surpluses available. In some cases, a TO

[4] This document applies to qard as discussed above. The document does not seek to supersede or overwrite any regulatory or policy documents issued by the BNM.

[5] Paragraph 19.2 of the BNM TOF states '*a deficit occurs when assets of the PRF are insufficient to meet the liabilities of the PRF, where assets and liabilities refer to the total assets of the PRF and the sum of actuarial liabilities and other liabilities [footnote 26 is omitted] of the PRF, respectively, as reported in the balance sheet of the takaful funds*'.

would waive its right to receive qard repayments;[6] for example, when the deficits in the TF are persistent and the qard is deemed not to be recoverable.

1.12 Based on current instances of qard in takaful entities and the relevant requirements in the IFSA and the BNM policy document *Qard*:

(a) qard is to be profit-free in nominal terms – that is, no more than the nominal amount would be repaid to a TO (paragraph 14.1 of *Qard* policy document, February 2018) and

(b) qard is an unsecured liability of a TF. In the case of a winding up, under section 218 of the IFSA, TF assets must be applied to meet the liabilities to takaful participants or proper claimants[7] in respect of that TF, which have priority over all unsecured liabilities, which includes any qard (or other forms of financial support referred to in IFSA, section 95).

Accounting pronouncements

1.13 In discussing the issues, this Issues Bulletin refers to the following accounting pronouncements:

~ MFRS 9 *Financial Instruments* (MFRS 9)

~ MFRS 13 *Fair Value Measurement* (MFRS 13)

~ MFRS 15 *Revenue from Contracts with Customers* (MFRS 15)

~ MFRS 17 *Insurance Contracts* (MFRS 17)

~ MFRS 108 *Accounting Policies, Changes in Accounting Estimates and Errors* (MFRS 108)

~ MFRS 112 *Income Taxes* (MFRS 112)

~ MFRS 132 *Financial Instruments: Presentation* (MFRS 132)

~ MFRS 137 *Provisions, Contingent Liabilities and Contingent Assets* (MFRS 137)

~ *Conceptual Framework for Financial Reporting* (Conceptual Framework)

1.14 There may be no particular Standard that applies to qard in certain circumstances; however, a particular MFRS might be applicable by way of analogy or it may be necessary to consider the Conceptual Framework. MFRS 108.10 and 11 say (emphasis added):

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6 This is the implication of S 16.1(d) in BNM policy document *Qard* issued on 26 February 2018 [BNM/RH/PD 028-7]. S16.1(d) states that: "*A qard contract is completed upon fulfilment of all obligations of the contracting parties under the qard contract, which include settlement of the qard amount either by way of … or full waiver by the lender of his right to qard*." Paragraph 19.4 of the BNM TOF requires the TO to determine the time period during which qard shall be repaid and consequently the period beyond which any unpaid qard may be considered irrecoverable.

7 Under IFSA, section 2(1) says: "proper claimant" means a person who claims to be entitled to the whole or part of the takaful benefits under a takaful certificate as executor of the deceased takaful participant, parent or guardian of an incompetent nominee or an assignee or who claims to be otherwise entitled to the takaful benefits under the relevant law.

> 10 **In the absence of a MFRS Standard that specifically applies to a transaction**, other event or condition, **management shall use its judgement in developing and applying an accounting policy** that results in information that is:
>
> (a) relevant to the economic decision-making needs of users; and
>
> (b) reliable, in that the financial statements:
>
> (i) represent faithfully the financial position, financial performance and cash flows of the entity;
>
> (ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;
>
> (iii) are neutral, ie free from bias;
>
> (iv) are prudent; and
>
> (v) are complete in all material respects.
>
> 11 **In making the judgement described in paragraph 10, management shall refer to**, and consider the applicability of, the following sources in descending order:
>
> (a) **the requirements in MFRS Standards dealing with similar and related issues**; and
>
> (b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the ***Conceptual Framework*** *for Financial Reporting* (*Conceptual Framework*).

Review of takaful entity financial statements

1.15 A MASB staff 'desktop' review of 15 takaful entity financial statements[8], including the accounting policy notes[9], shows existing practice is to:

(a) classify qard as a payable of the TF and a receivable of the TO; and

(b) measure qard at 'cost' (nominal amount) for both the TF and TO.

1.16 The review of financial statements also identified that TOs assess impairment either: (a) based on indicators in MFRS 136 *Impairment of Assets*; or (b) automatically at each reporting date.

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[8] In October 2020, MASB staff performed a desktop review of takaful entity financial statements for the years ending 31 December 2019 (11 entities); 31 March 2020 (three entities); and 30 June 2019 (one entity) on accounting for qard.

[9] Although qard is not currently prevalent (four out of 15 companies considered), even those companies without qard had a stated accounting policy on treating qard as a payable/receivable.

2.0 Overview and Conclusions of this Issues Bulletin

2.1 For typical groups of takaful contracts that generate surpluses (surplus groups), there will be no qard triggered, and consequently no accounting is required in respect of qard for either a TF or a TO.

2.2 A TF that is party to groups of takaful contracts that generate deficits before recourse to other sources (deficit groups) may, depending on circumstances, have recourse to several sources to fund those deficits:

(a) Future expected liquidity surpluses from takaful contracts currently generating liquidity deficits,

(b) Accumulated reserves from past surplus takaful contracts i.e. retained surplus or unallocated surplus, and/or

(c) Current or future surpluses from other in-force takaful contracts[10].

2.3 If, and only if none of these existing resources is immediately available, a TF would expect to receive qard from a TO[11], and if so, would include the expected qard cash inflows and cash outflows in its fulfilment cash flows in applying MFRS 17.

2.4 When a TF actually receives a qard contribution from a TO:

(a) the amount included for expected qard inflows in the fulfilment cash flows of the TF's MFRS 17 liabilities would be decreased to reflect the receipt of those cash flows and

(b) the amount included for expected qard repayments (outflows) in the fulfilment cash flows of the TF's MFRS 17 liabilities would be adjusted to reflect the current value of the expected repayment of qard to the TO.

2.5 Consistent with other expected cash flows included in the measurement of the TF's MFRS 17 liabilities, the measurement of the expected repayment of the qard will be updated at the end of each reporting period to reflect:

(a) changes in the absolute amount that is expected to be repaid,

(b) changes due to other groups of contracts assuming responsibility for the amount expected to be repaid,

(c) actual repayments that occurred during the period, and

(d) the expected timing of qard cash flows.

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[10] Subject to the specific conditions of the takaful contracts which may restrict the extent to which surplus and deficits may be shared and borne by other takaful contracts.

[11] Consistent with the context set out in paragraph 1.3, this Issues Bulletin does not deal with the MFRS-compliant financial information of the TO that administers a TF. For those TO entities considering presenting MFRS-compliant financial information, either in standalone financial statements or within the financial statements of the combined takaful entity, refer section 4 of this Issues Bulletin.

2.6 Measuring qard in fulfilment cash flows at a value discounted for time value reflects the economic effect of the expected future cash flow, consistent with all the other cash flows measured in fulfilment cash flows. This accounting measurement does not affect the Takaful Fund's obligation to repay the nominal amount of qard, nor does it affect or change any rights of the takaful operator to receive repayment on outstanding qard[12].

[12] Refer to the Shariah Advisory Council of Bank Negara Malaysia (SAC) Resolution, *The Application of Time Value of Money Principle for Accounting Measurement of Qard Transaction between Shareholders' Fund and Takaful Fund* dated 27 April 2021: https://www.bnm.gov.my/documents/20124/1085561/%5BFor+issuance%5D+SAC+213+Meeting+Statement+-+Application+of+TVM+for+Qard.pdf

3.0 Insurance fulfilment cash flows

This section considers whether qard cash flows are fulfilment cash flows under takaful contracts from the TF perspective and would be accounted for within MFRS 17.
This section concludes the following from the TF perspective. Applying MFRS 17.2, the regulatory requirements of the IFSA are among the substantive features of the contractual relationship with the policyholder. Qard cash inflows and qard cash outflows arise as a direct consequence of issuing a group of takaful contracts.

3.1 MFRS 17 defines 'fulfilment cash flows' as:

> An explicit, unbiased and probability-weighted estimate (ie expected value) of the present value of the future cash outflows minus the present value of the future cash inflows that will arise as the entity fulfils insurance contracts, including a risk adjustment for non-financial risk.

Competing views on whether expected or actual qard cash flows are 'fulfilment cash flows' under MFRS 17

3.2 There are two competing views on whether expected or actual cash flows associated with qard should be included among the fulfilment cash flows used to measure takaful contracts at the level of TF columnar reporting.

(1) Qard cash flows are typically included in fulfilment cash flows. These cash flows are a consequence of takaful contracts and, accordingly, would be among the fulfilment cash flows used to measure takaful liabilities. That is, for a group of takaful contracts, to the extent that a TF expects to receive qard, and/or repay qard, those expected cash flows would be measured as part of the fulfilment cash flows for that group of contracts.

(2) Qard cash flows are typically not included in fulfilment cash flows. These cash flows are a consequence of an arrangement required by the IFSA, which is separate from takaful contracts and they would therefore typically not be among fulfilment cash flows under MFRS 17.

Qard as fulfilment cash flows

3.3 The terms of takaful contracts include the implied terms within the legal and regulatory framework that governs those contracts. This includes the requirement for any expected cash flow shortfalls to be met by contributions of qard from the TO (assuming the TF itself does not have sufficient resources to meet the shortfall). These terms are mutually known and accepted by the contracting parties, namely the takaful participants and the TO which is acting on behalf of a pool of takaful participants in managing the TF. In the absence of such contractual terms, there will be no triggering event for the qard contribution. Thus, the potential contribution of qard from a TO in these circumstances is a direct consequence of the issuance of a group of takaful contracts. It is relied upon by the participants and in the management of the TF and is enforced by the regulator. It can consequently be considered to be a substantive feature of a takaful contract, consistent with MFRS 17.2.

3.4 MFRS 17.2 states (emphasis added):

> An entity shall consider its substantive rights and obligations, whether they arise from a contract, law or regulation, when applying MFRS 17. A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral or implied by an entity's customary business practices. Contractual terms include all terms in a contract, explicit or implied, but an entity shall disregard terms that have no commercial substance (ie no discernible effect on the economics of the contract). **Implied terms in a contract include those imposed by law or regulation**. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries and entities. In addition, they may vary within an entity (for example, they may depend on the class of customer or the nature of the promised goods or services).

3.5 MFRS 17.34 states:

> Cash flows are within the boundary of an insurance contract if they arise from substantive rights and obligations that exist during the reporting period in which the entity can compel the policyholder to pay the premiums or in which the entity has a substantive obligation to provide the policyholder with insurance contract services.

3.6 The right of a TF to receive qard and its obligation to repay qard are substantive terms of a group of contracts. Consequently, the expected cash flows associated with qard are within the contact boundary until the right/obligation no longer exists. The right/obligation arises due to the existence of the group of contracts and would be included within boundary for those contracts. The contract boundary for the group of contracts extends until all the relevant fulfilment cash flows are extinguished, which includes qard cash flows. The qard cash flows would be extinguished once they are all received/repaid or transferred to other groups of contracts.

3.7 A deficit that gives rise to the need for qard would be the result of all the rights and obligations facing a TF, whether they arise from takaful contracts or other transactions and events (such as tax or foreign currency changes). However, it doesn't matter which particular right or obligation tips the TF into deficit, the source of the right to receive qard and the obligation to repay qard is takaful contracts issued under the IFSA. Accordingly, the qard cash flows are among the takaful contract fulfilment cash flows, regardless of the nature of all the costs that might have contributed to determining the amount of the deficit.

3.8 A TF may be expecting to have 'surplus' cash inflows which will be applied to repaying some[13] or all of the qard to the TO, either because:

(a) the contracts that give rise to a shortfall early in its coverage period are expected to yield a surplus later in the coverage period; and/or

[13] In some cases, a TO would waive its right to receive qard repayments for example, when the deficits in the TF are persistent. Refer footnote 4.

(b) legacy generations of contracts may have generated surpluses that are still available; and/or

(c) other in-force contracts are expected to yield a surplus[14]; and/or

(d) subsequent takaful contracts (not yet in-force) are expected to yield a surplus.

Similar to the cash inflows, to the extent that a TF expects to make such repayments, these repayments are also a direct consequence of the issue of a group of takaful contracts.

3.9 MFRS 17 does not specify that the cash flows arising from an insurance contract necessarily come from (or are paid to) the counterparties to the contracts themselves. For example, cash inflows under insurance contracts include salvage and subrogation cash inflows[15]; and cash outflows under insurance contracts include claim handling cost cash outflows[16]. Therefore, any expected qard cash inflows from a TO and expected repayments of qard to a TO are not disqualified from being takaful contract fulfilment cash flows merely because they are not cash flows between direct parties to the contract.

3.10 If the TF expects that the qard will be repaid from a group of contracts other than the one that generated the deficit, and that group (or those groups) of contracts are currently in force, the discussion in MFRS 17.B67 and B68 (under the heading 'Contracts with cash flows that affect or are affected by cash flows to policyholders of other contracts') would apply (emphasis added).

> B67 Some insurance contracts affect the cash flows to policyholders of other contracts by requiring:
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> (a) the policyholder to share with policyholders of other contracts the returns on the same specified pool of underlying items; and
>
> (b) either:
>
> (i) the policyholder to bear a reduction in their share of the returns on the underlying items because of payments to policyholders of other contracts that share in that pool, including payments arising under guarantees made to policyholders of those other contracts; or
>
> (ii) policyholders of other contracts to bear a reduction in their share of returns on the underlying items because of payments to the policyholder, including payments arising from guarantees made to the policyholder.
>
> B68 Sometimes, such contracts will affect the cash flows to policyholders of contracts in other groups. **The fulfilment cash flows of each group reflect the extent to which the contracts in the group cause the entity to be affected by expected cash flows, whether to policyholders in that group or to policyholders in another group**. Hence **the fulfilment cash flows for a group:**

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14 Subject to the specific conditions of the takaful contracts which may restrict the extent to which surplus and deficits may be shared and borne by other takaful contracts.

15 MFRS 17.B65(k).

16 MFRS 17.B65(f).

(a) **include payments arising from the terms of existing contracts to policyholders of contracts in other groups, regardless of whether those payments are expected to be made to current or future policyholders**; and

(b) exclude payments to policyholders in the group that, applying (a), have been included in the fulfilment cash flows of another group.

3.11 The ‘pool of underlying items’ mentioned in MFRS 17.B67 could be the activities of the whole TF[17].

3.12 MFRS 17.B68 does not specify how cash flows from one group of contracts might flow to another group. However, as indicated above, in paragraph 3.8, this type of cross-subsidisation could take place between different groups of contracts that are in-force at the same time (within the TF or a risk group). Alternatively, an older generation of contracts with an expected retained surplus might cross-subsidise a newer group of participants over time through the repayment of qard.

3.13 Any accounting loss recognisable on the original deficit group would thus be reduced to the extent that losses are cross subsidised by in-force groups of contracts or through older generations of contracts.

3.14 The expected repayment of qard included in the aggregate fulfilment cash flows of all groups of takaful contracts in the TF would be the nominal amount of the qard received, less for example:

(a) amounts of qard not expected to be repaid because the TF does not expect to be able to charge sufficient future contributions to generate surplus from future returns, due for example to the competitive nature of the market for takaful business, and/or

(b) the effect of the expected timing of qard cash flows that will be repaid over time at a profit free rate.[18]

3.15 To the extent that qard is not expected to be repaid, it would be recognised immediately by a TF as a reduction of the fulfilment cash outflow and a consequential reduction of any net loss recognised as set out in paragraph 3.13. To the extent to which fulfilment cash flows relating to qard are affected by their expected timing (see 3.14(b)), they would be adjusted as time passes (as the time value unwinds) with a corresponding finance expense for a TF[19]. At any given time, the amount of qard that would be required to be repaid is the nominal amount. The discount for the effect of the expected timing of deferred qard cash flows under MFRS 17 is to reflect the underlying

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[17] Or a subset of the TF if the terms and conditions of the takaful contracts restrict sharing of deficits and surpluses.

[18] Applying MFRS 17, fulfilment cash flows are measured considering the timing of cash flows. The value of a nominal amount expected to be paid at a future date where there is no compensation for time value (profit free rate) would usually be a lower amount than the nominal face value, with the difference in value reflecting the effect of time value. This time value effect reduces as the expected date of payment nears.

[19] MFRS 17.87.

economics of the contracts and is aimed at ensuring that the various cash flows (including expected repayments of qard) are recorded at their actual (nominal) amounts at the time they will be paid or received.

3.16 Future groups of contracts recognised subsequent to the initial receipt of qard would include qard cash outflows (repayments) if those groups of contracts are expected to generate a surplus, to the extent that the surplus is expected to be applied to repaying the qard (adjusted for the effect of expected timing of qard cash flows). The recognition of such future contract groups may:

(a) result in an adjustment to the qard the entity expects to repay, and/or

(b) applying MFRS 17.B68, result in a reduction in the amount the original loss-making group includes in its fulfilment cash flow measurement (with a consequential reversal of a loss previously recognised).

Why qard might not be fulfilment cash flows

3.17 Some parties argue that the fact that qard is not imposed by the contract, but rather by regulation, and that the regulation is imposed on the entity as a whole rather than through the takaful contracts negates the effect of MFRS 17.2. These parties note that qard is required through regulation for the purpose of safeguarding the financial stability of the TF, rather than treated as part of takaful business model. Therefore, the requirement for qard may be enforced by way of regulation rather than imposed by the takaful contract. As such, these parties argue that qard payments may fall outside the scope of MFRS 17.

3.18 The requirement that groups of contracts be limited to contracts issued no more than a year apart[20] was included in MFRS 17 to help ensure that entities present information that shows the development of profitability over time[21]. These parties also note that the outcome of including qard as a fulfilment cash flow would appear to be contrary to that objective. That is, the intention is to prevent entities from avoiding the recognition of onerous takaful contracts based on cross-subsidisation between generations of participants. Accordingly, including qard cash flows among fulfilment cash flows would seem inconsistent with the intention of MFRS 17 regarding the recognition of onerous contracts.

Conclusion

3.19 The MASB wishes to highlight that MFRS 17.2 is wide ranging in its phrasing. The MASB therefore considers that, given the requirements of section 95 of the IFSA, expected qard cash flows do arise from implied terms ‘imposed by law or regulation’ to a contract and that consequently those terms would be included in the consideration of the terms of the contract, as contemplated in MFRS 17.2. Accordingly, the fulfilment cash flows for each group of contracts (issued no more than a year apart) includes the potential contribution of qard,

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20 MFRS 17.22.

21 MFRS 17.BC136.

which may be needed to support deficit groups[22].

3.20 Further, the MASB has considered that MFRS 17.B67 to B71 intentionally override the requirements in MFRS 17.22 when the conditions of those paragraphs are met. Consequently, the MASB is of the view that a TF subject to takaful contractual terms would be required to include expected qard cash inflows and outflows in fulfilment cash flows applying MFRS 17[23].

Accounting requirements

3.21 A deficit triggering the need for a qard contribution is typically caused by a shortfall (see paragraph1.9 and paragraph 3.7) at the TF level. That shortfall may arise from the cumulative effect of shortfalls in a number of different groups of takaful contracts, set off up to a point against existing resources of the entity. As such, depending on the circumstances, it may be appropriate to allocate the qard received and the consequential repayment obligation to more than one group of contracts.

3.22 MFRS 17.24 states (emphasis added):

> An entity shall apply the recognition and measurement requirements of MFRS 17 to the groups of contracts determined by applying paragraphs 14–23. An entity shall establish the groups at initial recognition and add contracts to the groups applying paragraph 28. The entity shall not reassess the composition of the groups subsequently. **To measure a group of contracts, an entity may estimate the fulfilment cash flows at a higher level of aggregation than the group or portfolio, provided the entity is able to include the appropriate fulfilment cash flows in the measurement of the group, applying paragraphs 32(a), 40(a)(i) and 40(b), by allocating such estimates to groups of contracts.**

3.23 Applying MFRS 17.24, a TF could achieve a more faithfully representative outcome by determining the qard cash flows at an aggregated level, and then allocating the effect of those cash flows to all the affected groups on a rational basis.

3.24 This Issues Bulletin does not consider disclosures. However, in preparing this Issues Bulletin, stakeholders informed the MASB of the importance of transparency in regard to:

(a) the cumulative nominal amount of qard advanced to the Takaful Fund and included in fulfilment cash flows,

(b) the effect and cause of changes in those amounts from period to period, and

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[22] See paragraph 2.2.

[23] This Issues Bulletin does not consider disclosures. However, in preparing this Issues Bulletin, stakeholders noted the importance of transparency in regard to the nominal amount of qard included in fulfilment cash flows, the effect and cause of changes in those amounts from period to period, and the expected repayment period of qard. Stakeholders also stressed the importance of emphasising that the nominal amount payable is unimpacted by the measurement used for financial reporting purposes (see 3.15). Consequently, strong consideration should be given to including these items in disclosures applying MFRS 17.93 and MFRS 17.94.

(c) the expected repayment period of qard.

Stakeholders also stressed the importance of emphasising that the nominal amount of qard payable is not impacted by the measurement used for financial reporting purposes (see 3.15).

3.25 Under the heading of disclosures, MFRS 17 states:

> 93 The objective of the disclosure requirements is for an entity to disclose information in the notes that, together with the information provided in the statement of financial position, statement(s) of financial performance and statement of cash flows, gives a basis for users of financial statements to assess the effect that contracts within the scope of MFRS 17 have on the entity's financial position, financial performance and cash flows. To achieve that objective, an entity shall disclose qualitative and quantitative information about: (a) the amounts recognised in its financial statements for contracts within the scope of MFRS 17; (b) the significant judgements, and changes in those judgements, made when applying MFRS 17; and (c) the nature and extent of the risks from contracts within the scope of MFRS 17.
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> 94 An entity shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements. If the disclosures provided, applying paragraphs 97–132, are not enough to meet the objective in paragraph 93, an entity shall disclose additional information necessary to meet that objective.

3.26 Consequently, the MASB considers that compliance with MFRS 17 may require including the items listed in 3.24 in the notes to the financial statements. For example, below the reconciliation of fulfilment cash flows required by MFRS 17.101, an entity could likely satisfy the requirements of MFRS 17 by including a reconciliation of qard and narrative disclosure as set out below:

Measuring qard in fulfilment cash flows at a value discounted for time value reflects the economic effect of the expected future cash flow on qard, consistent with all the other cash flows measured in fulfilment cash flows. This accounting measurement does not affect the Takaful Fund's obligation to repay the nominal amount of qard, nor does it affect or change any rights of the takaful operator to receive repayment on outstanding qard.

The balance and reconciliations of fulfilment cash flows include obligations to repay qard advanced by the Takaful Operator to the Takaful Fund. Qard was advanced to the Takaful Fund by the Takaful Operator in compliance with the requirements on rectification of deficit set out in paragraph 19 of the BNM's Policy Document on *Takaful Operational Framework* (TOF), and consistent with those requirements, the amount does not bear any profit element throughout the repayment period. The amount is repayable if and to the extent the Takaful Fund has available resources. In accordance with paragraph 19.4 of the BNM TOF, the TO must determine a time period during which the qard shall be repaid and consequently the period beyond which any unpaid qard will be deemed irrecoverable. The table below reconciles the nominal value of the qard included in fulfilment cash flows.

Nominal amount	**20x1**	**20x0**
Opening balance	900	-
Amount advanced	-	1 000
Amount repaid	(100)	(100)
Closing balance	800	900

3.27 As noted above, in some cases, qard would be triggered when there is a deficit and qard repayments would be triggered when that deficit is followed by a surplus. This may give rise to changes in the contract boundaries of deficit groups. For example:

(a) Consider a deficit group providing one-year coverage in year 20X0 that results in a contribution of qard to the TF in year 20X1 (the entity has no other resources available to fund the deficit). Under ordinary circumstances, the deficit group would have been derecognised in 20X1 because the coverage periods have expired, and all the claims have been paid. However, if the qard cash flows are fulfilment cash flows, the deficit group would not be derecognised until the relevant qard cash flows are repaid, or transferred to another group, which may be many years later. This is comparable to certain contracts where loss emergence can occur a number of years after coverage has ended (for example Asbestos claims under workers' compensation insurance).

(b) Consider a contribution of qard is received by the TF in year 20X1 as a consequence of a deficit group. Contracts that will generate the surplus to enable the TF to repay the TO are expected to be issued in 20X4. If the qard cash flows are fulfilment cash flows, the expected repayments of qard would be recognised as expected cash outflows of the deficit group until the issue of the surplus generating contracts in 20X4. This will result in the recognition of an accounting loss to the extent of the expected current value of the repayment. Applying MFRS 17, this is a loss component. When the contracts are issued in 20X4, the remaining expected qard repayments will be recognised as fulfilment cash flows for those new contracts[24]. Simultaneously, the deficit group will be released from the obligation to repay the qard, resulting in a reversal of the previously recognised accounting loss.

Illustrative case A

3.28 For the purposes of illustration, assume a TF issues one takaful contact and estimates that cash inflows (contributions from the participant) will be MYR200, cash outflows (claims) will be MYR300, and expects the TO will contribute qard of MYR100 to make up the difference. For the purposes of this illustration, the entity is assumed to have, no other contracts in issue and no reserves it can call upon to fund the deficit (see paragraphs 2.2 and 2.3 above)[25]. The entity does not expect to be able to repay the qard.

Prior to any actual qard cash flows having occurred, ignoring any effect of the expected timing of qard cash flows or risk adjustment, at the time of initial recognition, the MFRS 17 liability for remaining coverage would be zero.

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[24] Under MFRS 17, the insurance contracts themselves would not be initially recognised until one or other of the events in MFRS 17.25 is met. These events are: (a) the beginning of the coverage period of the group of contracts; (b) the date when the first payment from a policyholder in the group becomes due; or (c) for a group of onerous contracts, when the group becomes onerous.

[25] Assumption is included in these illustrative cases for the purposes of simplifying the cases and isolating the effect of qard.

That is, because the qard cash inflows are included in measuring the takaful liability. At inception of the contract, the entity would recognise:

Contribution fulfilment cash inflows	MYR200
Qard fulfilment cash inflows	MYR100
Claim fulfilment cash outflows	MYR(300)
Takaful asset/liability	Nil
Surplus/deficit on issuing contract	Nil

If the actual cash inflows are as expected, the TO would need to contribute MYR100 of qard. On receiving the qard cash, the TF's journal entries would be:

	Debit	Credit
Qard cash received from TO as expected		
Cash	MYR100	
Takaful liability (Qard fulfilment cash inflows)		MYR100

Illustrative case B

3.29 Assume the same facts as for case A, except that the TF expects to repay 40% of the qard from the future issue of surplus generating contracts.

Contribution fulfilment cash inflows	MYR200
Qard fulfilment cash inflows[24]	MYR100
Qard fulfilment cash outflows[26]	MYR(40)
Claim fulfilment cash outflows	MYR(300)
Takaful liability	MYR40
Deficit on issuing contract[27]	MYR40

If the actual cash inflows are as expected, the TO would need to contribute MYR100 of qard. On receiving the qard cash, the TF's journal entries would be:

	Debit	Credit
Qard cash received from TO as expected		
Cash	MYR100	
Takaful liability (Qard fulfilment cash inflows)		MYR100

[26] The qard inflow is recorded separately in this illustration from the qard outflow. This is because it is expected that these flows will happen at different times.

[27] A deficit is recognised because, although the entity expects that it will generate surpluses on future contracts to repay the qard, those cash flows relate to contracts not yet issued and are therefore outside of the contract boundary (MFRS 17.35). In accordance with MFRS 17, deficits are recognised immediately in the Statement of Financial Performance.

If at the same time, the TF reassesses the expected repayment of qard, and concludes that it expects now to repay 60% (an increase of 20% over its first estimate) of the qard from the issue of future, surplus generating contracts, the entries would be:

	Debit	Credit
Update assumptions on qard repayment		
Deficit[28]	MYR20	
Takaful liability (Qard fulfilment cash outflows)		MYR20

Illustrative case C

3.30 For the purposes of illustration, assume the TF in Case B received all contributions as expected and paid all claims as expected. After concluding that contract, the Statement of Financial Position of the TF reflects:

Accumulated deficit	MYR60
Takaful liability (qard fulfilment cash outflow)	MYR60

3.31 The TF subsequently issues one new takaful contact and estimates that cash inflows (such as contributions from the participant) will be MYR300, cash outflows (such as claims) will be MYR250, and consequently expects to generate a surplus and be able to repay the TO qard of MYR50.

3.32 Prior to any cash flows the MFRS 17 liability for remaining coverage for the new contract would be zero. That is, because the qard cash outflows are included in measuring the takaful liability, the contract is not regarded as surplus generating.

Contribution fulfilment cash inflows	MYR300
Claim fulfilment cash outflows	MYR(250)
Qard fulfilment cash outflows	MYR(50)
Takaful asset/liability	nil

3.33 However, the new contract is assuming the liability of some of the obligation to repay qard from the previous generation of contracts. Consequently, in addition to recording the recognition of the new contract above, the following journal would be required:

28 The deficit recognised is increased to reflect the change in expectations. The increase in the deficit is recognised immediately in the Statement of Financial Performance.

	Debit	Credit
Update assumptions on qard repayment		
Takaful liability (qard fulfilment cash outflow)	MYR50	
Reversal in deficit previously recognised		MYR50

3.34 If the actual cash inflows are (as expected) MYR300 and actual claims cash outflows are MYR250, the TF would need to repay MYR50 of qard. On repaying qard cash, the TF's journal entries would be:

	Debit	Credit
Qard cash paid to TO as expected		
Takaful liability (qard fulfilment cash outflow)	MYR50	
Cash		MYR50

3.35 If all cash flows occur as expected, at the conclusion of this (2nd) contract, the Statement of Financial Position of the TF reflects:

Accumulated deficit	MYR10
Takaful liability (qard fulfilment cash outflow)	MYR10

Other considerations

3.36 Once a deficit that cannot be funded from other resources of the TF is expected, it would also be expected that qard would be contributed. Accordingly, the contribution and the expected repayment of the contribution would be an expected fulfilment cash flow and included in measuring the liability for remaining coverage, at least until the coverage period for the group of contracts expires. Once that coverage period expires, to the extent qard is expected to be received and repaid to help meet incurred claims, it may be included in the liability for incurred claims.

3.37 In Paragraph 3.19, the MASB concludes that a TF subject to takaful contractual terms would be required to include expected qard cash inflows and outflows in fulfilment cash flows applying MFRS 17. The MASB considered[29] whether there are circumstances in which qard arises for reasons other than to rectify a deficit arising from issued takaful contracts but did not identify any such circumstances.

[29] The MASB also consulted with a number of Takaful operators and with Takaful representative organisations. Although those consultations identified a number of transactions or events that are similar in nature to qard, no circumstances were positively identified where qard arises for reasons other than to rectify a deficit. See also 4.1.

4.0 Other considerations

4.1 In arriving at the conclusions set out in this Issues Bulletin, the MASB considered how other MFRSs, including MFRS 9 would be applied to qard in the unlikely event that qard did not meet the definition of fulfilment cash flows. However, given the conclusion set out in paragraph 3.19 read with the conclusion set out in paragraph 3.37, those considerations are not relevant to the Issues Bulletin and are therefore not included.

4.2 The MASB also considered the accounting implications of qard for the TO. However, given the context set out in paragraph 1.3, those considerations are considered outside of scope of the Issues Bulletin and are therefore not included.

4.3 None-the-less, the MASB consider that the deliberations referred to in 4.1 and 4.2 may be useful in providing context to the conclusions reached in the Issues Bulletin and/or may assist entities in exercising the judgements and estimates required by those other standards. Consequently, the discussions and conclusions of the MASB are available as an Annex to this Issues Bulletin.

4.4 The contents of the Annex are not necessary for the understanding of this Issues Bulletin or its conclusions.

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