Financial Accounting Standard No. (19)

Contributions in Islamic Insurance Companies

Contents

Preface

This standard aims to set out the accounting rules for recognizing, measuring, presenting and disclosing the contributions made on the basis of donation by the policyholders relating to general insurance (property and casualty insurance) and/or the portion of contributions donated by the policyholders relating to insurance on persons (*Takaful*) in Islamic insurance companies (company/companies).[1]

(1) Referred to hereafter as company or companies to represent Islamic insurance companies and what is called Takaful companies.

Statement of the Standard

1. Scope of the Standard

This standard shall apply to the contributions made on the basis of donation by the policyholders relating to general insurance. The standard shall also apply to the portion of contributions made on the basis of donation by the policyholders relating to insurance on persons (Takaful).

The standard shall not apply to the portion in the contributions that relate to investment or saving in insurance on persons.

Should the requirements of this standard be in conflict with the company's charter or the laws and regulations of the country in which it operates, a disclosure should be made of the conflict. (para. 1)

2. Recognition of Contributions

2/1 On the inception date of the insurance policy or the inception of the risk insured against, earned contributions shall be recognized as a separate item under "Earned contributions", in the "Statement of Policyholders' Revenue and Expenses". In case where the contributions are undertaken by intermediaries, the commission of the intermediaries shall be recognized separately as an expense in the "Statement of Policyholders' Revenue and Expenses". (para. 2)

2/2 On the inception date of the insurance policy or the inception of the risk insured against, unearned contributions relating to subsequent financial periods shall be recognized on the liabilities side of the Statement of Financial Position under "Unearned contributions". (para. 3)

2/3 At the end of the financial period, the contributions which are due to be received shall be recognized on the assets side in the Statement of Financial Position under "Contributions receivable" as an item of the policyholders' equity. (para. 4)

2/4 At the end of the financial period, the company shall estimate the changes in the contributions, if any, relating to the types of insurance policies that are subject to change and shall recognize the changes as follows:

a) In case there is an increase (addition) in the contributions, it shall be recognized when the company has assurance of receiving such increment;

b) In case there is a decrease (return) in the contributions, it shall be recognized when the company has assurance of such decrease.

In both cases, the company shall take into consideration that these changes and their effect on the original contributions reflect the risks attached to these contributions when determining the earned and unearned portion of contributions at the end of the financial period. (para. 5)

2/5 On the inception date of the insurance policy or the inception of the risk insured against, the share of reinsurance from earned contributions shall be recognized as an expense in the "Statement of Policyholders' Revenue and Expenses" under "Reinsurance share". (para. 6)

2/6 On the inception date of the reinsurance contract with Islamic reinsurance companies, the reinsurance commission due to the insurance company shall be recognized as a revenue under "Reinsurance commissions" in the "Statement of Policyholders' Revenue and Expenses". (para. 7)

3. Measurement of Contributions

At the end of the financial period, the contributions for different types of insurance shall be measured as the amount determined by the company. Contributions are estimated by the company's actuaries based on actuarial techniques and statistical methods relating to insurance operations, in addition to the international prevailing practices and the regulations issued by the company's country of origin. Contributions undertaken through the intermediaries shall be measured by the amount underwritten by the intermediary and the obligation to transfer to the company either the gross amount underwritten or the net amount after deduction of the commission. (para. 8)

4. Presentation in the Financial Statements

Earned contributions shall be presented at the end of the financial period under “Earned contributions” in the “Statement of Policyholders’ Revenue and Expenses”. The amount presented shall be net of the following deductions:

a) The amount of reinsurance share;
b) The amount of change in the contributions relating to the insurance policies initiated in the previous financial periods;
c) The amount of change in the unearned contributions;
d) Any change in the contributions relating to insurance policies initiated on behalf of the company by the intermediaries before the end of the financial period in order to reach the net earned contributions. (para. 9)

5. Disclosure in the Notes to the Financial Statements

5/1 Disclosure shall be made of the accounting policies adopted by the company in the treatment of contributions from both general insurance and insurance on individuals. (para. 10)

5/2 Disclosure shall be made of the accounting policies adopted by the company in the treatment of any changes that may occur on the contributions during the financial period. (para. 11)

5/3 Disclosure shall be made of the accounting policies adopted by the company, during the insurance policy period, in the treatment of the following cases:

a) Withdrawal of a policyholder and his ineligibility for any part of the contribution;
b) Withdrawal of a policyholder and his eligibility for part of the contributions based on the remaining period of the insurance policy;
c) Cancellation of the insurance policy and the consequences thereof on the eligibility of the policyholders for part or whole of the contributions according to any of the conditions that allow or do not allow the company to cancel the policy;
d) Any other method. (para. 12)

5/4 Separate disclosure shall be made of the contribution receivables relating to policyholders, other insurance companies and reinsurance companies. (para. 13)

5/5 Disclosure shall be made of the breakdown of the contributions on the basis of insurance segments and type of insurance. (para. 14)

6. General Disclosure Requirements

The disclosure requirements stated in the Financial Accounting Standards related to Islamic insurance companies issued by the Accounting and Auditing Organization for Islamic Financial Institutions shall be observed. (para. 15)

7. Effective Date

This Standard shall be effective for financial periods beginning 1 Muharram, 1425 A.H. or 1 January, 2004 A.D. (para. 16)

Adoption of the Standard

The Standard of Contributions in Islamic Insurance Companies standard was adopted by the Accounting and Auditing Standards Board in its meeting No. (25) held on 3 Rabi' II, 1424 A.H., corresponding to 3 June, 2003 A.D.

Members of the Board

1. Mr. Amer Sulaiman Al-Beireqdar	Chairman
2. Mr. Essa Abdullah Zainal	Deputy Chairman
3. Mr. Salman Bin Essa Al Khalifa	
4. Mr. Mohammed Al Hassan Al Shaikh	
5. Dr. Nordin Mohammed Zain	
6. Mr. Abdul-Hamid Abu Mousa	
7. Sheikh Essam Mohammed Ishaq	
8. Mr. Mohammed Alawi Thiban	
9. Mr. Mohammed Said Abdel-Wahab	
10. Dr. Abdul-Hamid Mahmood Al-Bali	
11. Mr. Saleh Mousa Al-Shanteer	
12. Mr. Ebrahim Sidat	
13. Mr. Yousif Abdullah Taqi	
14. Dr. Mohamed Nedal Alchaar	Secretary General/ Rapporteur

Appendix (A)
Brief History of the Preparation of the Standard

In its meeting No. (16) held in Jeddah in Saudi Arabia on 8-9 Ramadan 1419 A.H., corresponding to 26-27 December 1998 A.D., the Accounting and Auditing Standards Board decided to give priority to the preparation of a standard on Contributions in Islamic Insurance Companies.

On 1 Ramadan 1421 A.H., corresponding to 27 November 2000 A.D., a consultant was commissioned to prepare a preliminary study on the accounting aspects of the standard. Another consultant was commissioned to prepare a study on the juristic aspects of the standard.

In its meeting No. (32) held in the Kingdom of Bahrain on 16 Muharram 1423 A.H., corresponding to 30 March 2002 A.D., the Accounting Standards Committee discussed the preliminary study and made necessary amendments. The Committee also discussed the revised accounting study and the exposure draft of the standard in its meeting No. (33) held in the Kingdom of Bahrain on 27 Rabi' I, 1423 A.H., corresponding to 8 June 2002 A.D., and requested the consultants to make the necessary amendments in light of the comments made by the members.

The revised exposure draft of the standard was discussed by the Accounting Standards Committee meeting No. (34) held in Jordan on 15 Rabi' II, 1423 A.H., corresponding to 26 July 2002 A.D., and necessary amendments were made.

The exposure draft of the standard was discussed by the Shari'a Committee for Standards in its meeting No. (7) held in Kingdom of Bahrain on 2-3 Rajab 1423 A.H., corresponding to 9-10 September 2002 A.D., and some additional amendments were made.

The amended exposure draft was discussed in the Accounting and Auditing Standards Board meeting No. (24) held in Bahrain on 21 Sha'ban 1423 A.H., corresponding to 27 October 2002 A.D. The Accounting and Auditing Standards Board made some amendments to the exposure draft and decided that it should be distributed to specialists and interested parties to obtain their comments on the exposure draft in order to discuss them in a public hearing.

A public hearing was held in Bahrain on 17 Dhul-Hajjah 1423 A.H., corresponding to 18 February 2003 A.D. The public hearing was attended by more than 20 participants, representing central banks, Islamic banks, accounting firms, Shari'a scholars, academics and others who are interested in this field. Members of the Accounting Standards Committee responded in the public hearing to the written comments as well as to the oral comments that were expressed in the public hearing.

The Accounting Standards Committee held its meeting No. (35) on 27 Muharram 1423 A.H., corresponding to 30 March 2003 A.D., in Bahrain to discuss the comments made on the exposure draft. The Committee made the necessary amendments, which it deemed necessary in light of the discussions that took place in the public hearing.

The Accounting and Auditing Standards Board adopted the proposed standard in its meeting No. (25) held in Bahrain on 3 Rabi' II, 1424 A.H., corresponding to 3 June 2003 A.D.

Appendix (B)
Juristic Rules for Contributions in Islamic Insurance Companies

The basis for recognizing unearned contributions under "liabilities" is that a contribution is considered in return of an underwriting for the policy period, which may not match with the financial period. Accordingly, what relates to a certain period should be allocated over that period except when parts of this period expire. This is similar to the Shari'a principle relating to Ijarah in terms of spreading the rent over the contract period, and that the rent becomes due gradually depending on the utilization of the rented premises.

Although it is based on the principle of donation, a contribution is required from the participant because according to the Maliki school of thought, such contributions are considered to be obligatory on the committed party once it undertakes to donate.

The basis for recognizing unpaid contributions under "Contribution receivables" is that contributions become a debt on the part of the donor, once he undertakes to donate, and the company has the right to claim it by way of legal proceedings.

The basis for the need to consider the matching of the risks with their respective contributions when recognizing the change in case of an increase or decrease in contributions is that contributions are made as donation for a certain purpose, i.e. covering certain compensations needed by the policyholders. Therefore, the realization of this purpose should be taken into consideration when determining the contributions by the company's actuarial experts. The basis for relying on the actuarial expert estimates, although it involves uncertainty and are based on assumptions, is that a reasonable degree of uncertainty is acceptable in business matters and consulting the experts is a matter that is established in Shari'a and has many examples of applications.

The basis for the application of one of the cases specified in the standard in respect of the withdrawal of the policyholder or his cancellation of the insurance policy during its term is that this should be specified in the policy as one of its terms and conditions. The hadith says: *"Muslims are bound by their conditions"*. Therefore, the condition to return the entire amount or part of it when the company revokes the policy or when the policyholder revokes it is part of making the donation contingent upon a condition.

Appendix (C)
Reasons for the Standard

A study was conducted on a sample of eight Islamic insurance companies. The study revealed that there are major differences between these companies in respect of recognition, measurement, presentation and disclosure of contributions made by policyholders. These are summarized as follows:

a) There are differences in the accounting policies adopted in the recognition of earned and unearned contributions;
b) The majority of the insurance companies in the sample do not disclose the treatment of the changes (increase/decrease) in the contributions in their annual reports;
c) There was inadequate disclosure of the accounting policies for the treatment of withdrawal of a policyholder or the cancellation of an insurance policy by the company during the policy period;
d) Some insurance companies do not provide segmental information on their insurance contributions.

These differences and variations in recognition, presentation and disclosure impair the comparability of the financial information presented in the companies' financial statements, and hence affect the economic decisions of users of financial statements. The differences also impair the transparency concept due to inadequate disclosure of vital information in the financial statements. It also affects the fairness concept and the determination of the rights of the concerned parties by recognizing, presenting and disclosing of the contributions as an item owned by the policyholders.

Appendix (D)
Basis for Conclusions

The conclusions reached by this standard mainly emanate from the application of the objectives of financial reports and the concepts of financial accounting for Islamic financial institutions on the companies to the extent applicable. Such objectives are geared to the needs of the categories of the users of such reports as specified in the previous Statement of Financial Accounting No. (1): Objectives of Financial Accounting for Islamic Banks and Financial Institutions, and the previous Statement of Financial Accounting No. (2): Concepts of Financial Accounting for Islamic Banks and Financial Institutions (referred to hereafter as the Statement of Objectives and the Statement of Concepts, respectively).

The previous Statement of Objectives requires the following:

a) Determination of the rights and obligations of all interested parties.
b) Contribution to the safeguarding of the assets and rights of the interested parties.
c) Provision, through financial reports, of useful information to users of these reports, to enable them to make informed decisions in their dealings with institutions.

Accordingly, the standard requires:

a) The recognition of earned contributions that relate to the current financial period, as a separate item, in the "Statement of Policyholders' Revenue and Expenses".
b) The recognition of unearned contributions that relate to subsequent financial periods, as a separate item, in the "Statement of Financial Position".
c) The recognition of contribution receivables in the Statement of Financial Position on the assets side as an item of policyholders' equity.

d) The recognition of estimated changes in the contributions of some types of insurance policies.

This is in compliance with the objectives of the fair determination of rights and obligations of all interested parties and the faithful representation of their rights.

The previouy Statement of Objectives requires that financial reports should provide information on the institution's economic resources and its related obligations, and the effects of transactions, other events and circumstances on the institution's economic resources and obligations. This information should assist users of the financial statements in assessing the inherent risk of their investment. Accordingly, the standard requires that the financial statements shall disclose the accounting policies adopted in the treatment of contributions relating to both general insurance and insurance on individuals, and the accounting policies adopted by the company in the treatment of changes in contributions during the financial period. The standard also requires disclosure of the accounting policies adopted by the company in the treatment of the cancellation of an insurance policy or the withdrawal of a policyholder during the financial period. The standard also requires separate disclosure of the contribution receivables relating to policyholder, other insurance companies and reinsurance companies and disclosure of the contributions on the basis of insurance segments and type of insurance.

Appendix (E)
Definitions

Contributions

This is the gross amount which an insurance policyholder undertakes to pay in an insurance contract issued by the company.

Earned Contributions

This is the portion of contributions that relate to the current financial period for insurance contracts issued by the company.

Unearned Contributions

This is the portion of contributions for insurance contracts issued by the company during the current financial period, but the duration of the contracts extends to future financial period or periods. Accordingly, the portion of the contributions that relates to the latter periods is not realised in the current financial period.