[Exposure Draft (F1/2020) v13.0 of the]

Financial Accounting Standard __

Presentation and Disclosures in the Financial Statements of Takaful Institutions

Contents

AAOIFI Financial Accounting Standard (FAS) __ "Presentation and Disclosures in the Financial Statements of Takaful Institutions" is set out in paragraph 01-14. All the paragraphs have equal authority. This standard should be read in the context of its objective and the AAOIFI Conceptual Framework for Financial Reporting.

All AAOIFI FASs shall be read in conjunction with the definitions, Shari'ah principles and rules and key considerations provided by AAOIFI Shari'ah Standards (SSs) in respect of such products and matters. This standard shall be read in conjunction with the requirements of "Part 1: Applicable on all institutions" of FAS 1 "General Presentation and Disclosures in the Financial Statements of Islamic Financial Institutions"(Revised 2020).

Preface

PR1 AAOIFI has previously issued four specific Financial Accounting Standards (FASs) applicable on Islamic insurance / Takaful, between the years 1999 to 2003. The Takaful industry, during the last two decades, has developed significantly along with considerable enhancement to the regulatory environment. Concurrently, other international accounting standard setting bodies completed multiple projects related to insurance accounting. The then AAOIFI Accounting, Auditing and Governance Standards Board initiated a comprehensive revision project for FASs on Takaful in 2013.

PR2 The work was paused in 2016 by the newly formed AAOIFI Accounting Board (AAB / the board) considering the fact that Takaful regulations were being enhanced in many jurisdictions, and the projects by international accounting standard setters related to the insurance accounting were nearing completion. The board also agreed that the ongoing project of revision of the AAOIFI Conceptual Framework for Financial Reporting and FAS 1 "General Presentation and Disclosures in the Financial Statements of Islamic Financial Institutions[1]" (Revised 2020) shall have priority as certain parts and terminologies will be used by later standards.

PR3 AAB initiated a comprehensive revision project for FASs on Takaful in 2018 under the recommendation of the "AAOIFI Financial Accounting Standards (FAS) review and revision project".

PR4 This revised FAS supersedes the existing FAS 12 "General Presentation and Disclosures in the Financial Statements of Islamic Insurance Companies" and is the first part of the deliverables of the Takaful project. The second part of the project is expected to cover the specific requirements for accounting for Takaful that will replace the other three existing FASs on Takaful accounting.

[1] Presently FAS 1 "General Presentation and Disclosure in the Financial Statements of Islamic Financial Institutions". The existing standard is undergoing a revision process and an exposure draft of the revised standard has been issued for comments.

Introduction

Overview

IN1 This revised FAS __"Presentation and Disclosures in the Financial Statements of Takaful Institutions" improves the presentation and disclosure requirements, in line with the global best practices, and supersedes the existing FAS 12 "General Presentation and Disclosures in the Financial Statements of Islamic Insurance Companies".

IN2 This standard prescribes the set of financial statements that should be periodically published by the institutions to satisfy the common information needs of users of financial statements. This standard also establishes the general principles for the presentation of information and defines certain information that should be disclosed in the financial statements of Takaful institutions in order to achieve the objectives of accounting and financial reporting.

IN3 The standard shall be accompanied by, and read in conjunction with, FAS __ "Accounting for Takaful Contracts[2]" that covers the major aspects of accounting for Takaful products.

Rationale for issuing this standard

IN4 AAOIFI issued the existing four standards on Takaful accounting and financial reporting about two decades back. The Takaful industry, the relevant regulations, as well as the accounting best practices for insurance sector have significantly developed and enhanced since then. AAOIFI has recently completed the project of revision of AAOIFI Conceptual Framework for Financial Reporting, which standardize the fundamental accounting concepts applicable to various institutions and instruments. Consequently, it was considered essential to revise the standards for accounting and financial reporting for Takaful institutions.

Significant changes from previous standard

IN5 This standard (FAS __) brings significant changes from its predecessor standard (FAS 12 "General presentation and disclosures in the financial statements of Islamic Insurance Companies"), inter alia, in the following aspects:

a. the presentation and disclosure in the standard have been aligned with the Shari'ah principles and rules relating to Takaful, whereby the Takaful institution (operator) is distinct from the participants' funds (including participants' Takaful fund (PTF) and participants' investment fund (PIF);

b. the PTF and PIF are considered to be off-balance-sheet assets under management, therefore separate from the Takaful institution;

c. statements for the managed PTF and the management PIF have been introduced, some of which were not part of the earlier FAS, including a separate statement of financial position for managed PTF;

d. disclosures for Zakah, charity and Qard funds have been relocated to the notes to the financial statements in line with FAS 1 (Revised 2020);

[2] This FAS is under development.

e. new definitions for Takaful, Takaful institution, Takaful operator, PIF, and the PTF have been introduced; and

f. the standard has been aligned with FAS 1 (Revised 2020).

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AAOIFI Financial Accounting Standard ___
Presentation and Disclosures in the Financial Statements of Takaful Institutions

Objective of the standard

1. The objective of this standard is to set out the overall requirements for presentation of financial statements, the minimum requirement for the contents of, and disclosures in, the financial statements, and a recommended structure of financial statements that facilitates faithful presentation in line with Shari'ah principles and rules for Takaful institutions.

Scope

2. This standard is applicable to all Takaful institutions regardless of their legal form or size, including Takaful window operations.

3. This standard is applicable to the Takaful institutions while presenting consolidated financial statements, as well as, the stand-alone or separate financial statements.

4. This standard does not apply to the structure and contents of condensed or summarized financial reports prepared for interim financial reporting.

5. This standard shall be read in conjunction with the requirements of "Part 1: Applicable on all institutions" of FAS 1 "General Presentation and Disclosures in the Financial Statements of Islamic Financial Institutions[3]" (Revised 2020), whereby the requirements of this standard shall be considered in addition to the requirements prescribed therein with regard to the general presentation and disclosures in the financial statements of all Islamic financial institutions. The requirements of this standard shall, however, apply in case of a conflict between the requirements of the two standards.

Definitions

6. For the purpose of interpreting and applying this standard, the following short definitions are relevant:

   a. Owners' equity – is the residual interest in the assets of the institution after deducting all the liabilities and the quasi-equity [Explanation: In the context of Takaful institutions, it represents only the equity related to Takaful operator / shareholders];

   b. Participants' (also referred to as, policyholders') investment fund (PIF) – is the fund managed by the Takaful institution on behalf of participants collectively with the objective of making

[3]Presently FAS 1 "General Presentation and Disclosure in the Financial Statements of Islamic Financial Institutions". The existing standard is undergoing a revision process and an exposure draft of the revised standard has been issued for comments.

investment and earning returns thereon, based on Mudaraba or Al-Wakala Bi Al-Istithmar (investment agency);

c. Participants' (also referred to as, policyholders') Takaful fund (PTF) – is the fund created by the participants with the objective of sharing risk, whose management has been undertaken by the Takaful institution. The fund is entitled to the contributions and returns, is subject to direct expenses, provisions and reserves related to the Takaful operations, and the surplus (or deficit) arising thereon;

d. Qard [also referred to as Qard Hasan] – is an interest-free loan intended to allow the borrower to use the loaned funds, with or without prescribing a period of time, with the understanding that the same amount of the loaned funds (in the original nature of funds e.g. same currency) would be repaid when due, or when demanded (in case the period is not prescribed) [Explanation: In the specific context of this standard, it refers to the interest-free loan extended by the Takaful operator to the PTF to temporarily fund the deficit in the PTF];

e. Reinsurance – is a (conventional) contract according to which an insurance company cedes (transfers) part of the risks of its insurance commitments to a reinsurance company. The insurance company, therefore, undertakes to pay to the reinsurance company part of the insurance premium paid by the policyholders, against commitment of the reinsurance company to bear part of the claims as per an agreement between the two parties;

f. Re-Takaful – is the Shari'ah compliant alternative to the conventional reinsurance having the distinctive characteristic of being based on the same principles of Takaful and mutuality as indicated in SS 26 "Islamic Insurance". The need for re-Takaful may arise in respect of a Takaful institution due to lack of sufficient capacity to take risks or because of regulatory requirements of risk sharing with regard to the magnitude of the risk in question;

g. Takaful[4] – is a process of agreement among a group of persons to handle the injuries resulting from specific risks to which all of them are vulnerable. A process, thus initiated, involves payment of contributions as donations, and leads to the establishment of a Takaful fund that enjoys the status of a legal entity (from Shari'ah perspective) and has independent financial liability. The resources of this fund are used to indemnify any participant who encounters injury, subject to a specific set of rules and a given process of documentation. The fund is managed by either a selected group of participants, or a joint stock company that manages the Takaful operations and invests the assets of the fund, for an agreed fee;

h. Takaful institution – is an entity possessing the license of practicing Takaful (at times referred to as Islamic insurance) business in line with the requirements of Shari'ah principles and rules. The institution undertakes its operation based on a remunerated Wakala (agency) contract. In addition to managing the Takaful operations, the institution also assumes the responsibility of investing the assets of the fund through Mudaraba or investment agency [Explanation: For the purpose of this standard, a Takaful institution includes a Takaful

[4] Definition adapted from SS 26 "Islamic insurance".

window operation[5]. The notion Takaful institution, unless the context suggests otherwise, includes the Takaful operator and the participants' funds]; and

i. Takaful operator – in the specific context of this standard, represents the function of the Takaful institution whereby it manages the PTF and the PIF., and from accounting perspective, represents the residual part of the Takaful institution duly owned by and representing the equity, rights and obligations of the shareholders (or the principal owners) of the Takaful institution, excluding the PTF and PIF.

Presentation and disclosures in the financial statements

Complete set of financial statements

7. A complete set of financial statements of a Takaful institution shall comprise of the following:

   a. statement of financial position of the Takaful institution as at the end of the financial reporting period;

   b. statement of income and other comprehensive income[6] of the Takaful institution for the financial reporting period;

   c. statement of changes in owners' equity of the Takaful institution for the financial reporting period;

   d. statement of cash flows of the Takaful institution for the financial reporting period;

   e. statement of financial position of managed PTF, separately for the general and family operations, as at the end of the financial reporting period;

   f. statement of financial activities of the managed PTF, separately for the general and family operations, for the financial reporting period;

   g. statement of managed PIF as at the end of the financial reporting period; and

   h. notes, comprising significant accounting policies and other explanations.

Presentation and disclosure in financial statements

8. Financial statements shall faithfully present the financial position, financial performance, financial activities and cash flows of the Takaful institution and the managed funds.

9. The assets, liabilities and owners' equity, as well as, income and expenditure, gains and losses of the Takaful institution shall be presented separately from the assets, liabilities and surplus / deficit, and related income and expenditure, gains and losses of the managed PTF, or the managed PIF.

[5] Takaful window operation shall apply this standard in conjunction with the requirements of FAS 18 "Islamic Financial Services Offered by Conventional Financial Institutions", particularly paragraph 3, 6 and 7 thereof.

[6] According to paragraph 24 of FAS 1 "General Presentation and Disclosures in the Financial Statements of Islamic Financial Institutions" (Revised 2020), an institution may present a single statement of income and other comprehensive income, or a statement of income, and a statement of other comprehensive income presented as two separate statements.

10. The general presentation and disclosure requirements, including common components of a complete set of financial statements of a Takaful institution are listed in appendix B of this standard, to be read with the relevant requirements of “Part 1: Applicable on all institutions” of FAS 1 (Revised 2020).

Accounting policies and estimates

11. In addition to the accounting policies prescribed in “Part 1: Applicable on all institutions” of FAS 1 (Revised 2020), a Takaful institution shall disclose the significant accounting policies including those pertaining to the managed PTF, and the managed PIF, including the policies with regard to:

    a. segregating, recording, and reporting the funds pertaining to the managed PTF and the managed PIF, separately from the Takaful operators’ funds;

    b. recognizing, deferring and amortizing earned contribution;

    c. recognizing outstanding claims and claims incurred but not reported, and recognizing provisions against onerous situations including any deficiency provision against shortfall of contributions versus claims;

    d. recognizing, deferring and amortizing (as applicable) Takaful business acquisition costs;

    e. recognizing commission earned from the re-Takaful institutions;

    f. recognizing and releasing of contractual service margin (CSM) and risk adjustment, as well as, segregating / aggregating Takaful investment income and amortizing deferred expenses in the statement of financial activities of managed PTF (as applicable);

    g. accounting for transfers / derecognitions;

    h. recognizing the relevant share of Takaful business from co-Takaful (and similar) arrangements, including the policy to recognize the relevant share of Takaful business from co-insurance arrangements which are not in compliance with the Shari’ah principles and rules;

    i. recognizing Qard-Hasan and its measurement including accounting for impairment thereon in the books of the Takaful operator and its contra accounting in the books of the PTF;

    j. recognizing income tax (including current and deferred) and its attribution to the managed funds as appropriate, to ensure fair and transparent treatment for different stakeholders, along with necessary explanation of the basis of computation of taxation and / or any exemptions available to the managed funds;

    k. recognizing Wakala fee and Mudarib’s share (for investment management activity, where applicable), and their timing of recognition, deferment, and amortization, in the books of the Takaful operator and its contra accounting in the respective books of the PTF and PIF; and

    l. recognizing and accounting for income, gains and losses from investments in line with relevant FAS and identifying the differences in classification of investments, as applicable, in case of managed funds ensuring avoidance of accounting mismatch.

Effective date

12. This standard shall be effective on the financial statements of the Takaful institutions beginning on or after 01 January 2023. Early adoption of the standard is permitted.

Transitional provisions

13. The application of this standard, per se, may not require any significant change in any accounting policy. However, the adoption of this standard, along with the FAS 1 (Revised 2020), FAS ___ "Accounting for Takaful Products[7]", and the necessary references to other FASs may require significant changes in accounting policies. The respective transitional provisions, if any, as prescribed by the respective FASs, shall be applicable to a Takaful institution while adopting this standard for the first time.

Amendments to other standards

14. This standard supersedes the earlier FAS 12 "General Presentation and Disclosures in the Financial Statements of Islamic Insurance Companies".

[7] This FAS is under development.

Appendices

Appendix A: Adoption of the standard

This standard was presented for the approval in the AAOIFI Accounting Board's meeting No. ___ held on ______ corresponding to __________ and was duly approved.

Members of the board

1. Mr. Hamad Abdulla Al Oqab – chairman
2. Mr. Syed Najmul Hussain – deputy chairman
3. Mr. Abdelhalim Elsayed Elamin
4. Mr. Abdulmalik Alsuwayni
5. Dr. Abdulrahman M. Alrazeen
6. Ms. Amal Al Masri
7. Dr. Bello Lawal Danbatta
8. Mr. Firas Hamdan
9. Mr. Hondamir Nusratkhujaev
10. Mr. Imtiaz Ibrahim
11. Mr. Irshad Mahmood
12. Dr. Muhammad Beltagi
13. Mr. Samet Arslan
14. Mr. Saud Al Busaidi
15. Mr. Yusuf Ibrahim Hassan

Reservation

The standard was approved unanimously.

Working group members

1. Mr. Irshad Mahmood – chairman
2. Mr. Omer Morshed – deputy chairman
3. Mr. Abdulla Ghazwan
4. Mr. Abdul Moid Ahmed Khan
5. Sheikh Ali Musleh Ali Sartawi
6. Sheikh Dr. Faizal Ahmad Manjoo
7. Mufti Hassan Kaleem
8. Ms. Intan Natasha Putri
9. Mr. Jamil Ahmed Shaikh
10. Mr. Kashif Siddiqui
11. Mr. Kazi Mortuza Ali
12. Dr. Luqyan Tamani
13. Mr. Mohamed Awad
14. Mr. Mohammed Hammad
15. Mr. M. Venkatesan
16. Mr. Rohail Asghar
17. Mr. Shahnawaz Khan
18. Dr. Sulaiman Aljewisser
19. Dr. Zakir Hossen Shaikh

Executive team

1. Mr. Omar Mustafa Ansari (AAOIFI)
2. Mr. Mohammad Majd Bakir (AAOIFI)
3. Mr. Haroon Tabraze (Senior Consultant-Researcher)
4. Ms. Farida Cassim (AAOIFI)

Appendix B: Minimum components of the financial statements of a Takaful institution

Application and scope

B1 The requirements of this appendix shall be applicable on a Takaful institution for the purpose of preparation of its financial statements, in addition to the relevant requirements of part A "Requirements applicable on all institutions" of FAS 1 "General Presentation and Disclosures in the Financial Statements of Islamic Financial Institutions[8]" (Revised 2020). [Explanation: The requirements as applicable to the statement of financial position and the statement(s) of income and other comprehensive income, shall also be applicable on the statement of financial position of managed PTF and statement of financial activities of the managed PTF, respectively, insofar as, these are related to the same and do not contravene the specific requirements of this appendix.]

B2 The components of the financial statements enumerated in this appendix shall be considered as a minimum requirement (unless considered immaterial). However, different captions, groupings and presentation styles may be followed by Takaful institutions in line with the nature of their business, regulatory requirements, and customary practices, subject to compliance with the principles contained in this standard.

General

B3 In line with the requirements of paragraph 9 of the standard, the assets, liabilities, and owners' equity, as well as, income and expenditure, gains and losses of the Takaful institution shall be presented separately from the assets, liabilities and surplus / deficit, and related income and expenditure, gains and losses of the managed PTF, or the managed PIF.

B4 A Takaful institution may distinguish the assets and liabilities (presented in different statements) between current and non-current, whereby current reflects those maturing within 12 months, if required by the local regulator or according to the prevalent practice in the jurisdiction. Alternatively, similar information may be provided by the institution elsewhere in the financial statements.

B5 A Takaful institution shall disclose all material information that is necessary to make the financial statements adequate, relevant, and reliable for their users, including the following:

a. a description of the Takaful model and the relationship between the Takaful institution and the managed funds; and

b. a description of the significant terms and conditions of the contracts between the Takaful institution and its managed funds including, but not limited to, Qard-Hasan, Wakala fee, and the share of Mudarib. This description is preferably to be presented after the accounting policies.

c. the nature of the activities the Takaful institution is authorized to carry out by its charter and the major Takaful services / operations it provides; and

[8] In case of a conflict between the requirements of the two standards, the requirements of this standard shall apply, as provided for in paragraph 5.

d. the Takaful institution's responsibility towards Zakah.

B6 The Takaful institution shall disclose any unusual supervisory restrictions imposed by any regulatory or supervisory agency. A supervisory restriction should be considered unusual if it either restricts management's ability to make decisions necessary to manage the institution, the PTF, the PIF, or if it prevents the management from carrying out some of the activities it has been authorized to carry out by the institution's charter.

B7 The Takaful institution shall also disclose the additional restrictions that arise due to the Waqf model (or any other permissible structure) used by the Takaful institution, or due to regulations applicable on statutory fund model (or any other similar structure), or the relevant solvency requirements in the respective regulatory jurisdictions.

B8 Disclosure shall be made in notes to financial statements relating to:

a. concentration of Takaful and re-Takaful risks in geographical areas, economic sectors, and location of the re-Takaful institutions; and

b. capital adequacy and solvency of the Takaful institution, both at the Takaful operator and the PTF level, indicating any difference in respect of previous assessment of the same that may arise from the regulatory reviews.

B9 Takaful institution shall disclose the guarantees and other similar arrangements, which are not part of PTF and rather are related to the Takaful operator, along with relevant accounting policies for accounting for any onerous commitments and income recognition therefrom.

B10 Disclosure for trust funds and other similar assets in fiduciary capacity shall be made, if applicable, in line with the requirements of relevant FASs.

Statement of financial position of the Takaful institution

Assets

B11 The following assets (pertaining only to the Takaful institution's owners) shall be presented as a minimum on the face of the statement of financial position or appropriately disclosed in the notes to the financial statements:

a. cash and balances with Islamic banks and other financial institutions;

b. deposits with regulators;

c. receivables from the managed PTF and managed PIF;

d. Qard-Hasan receivable from the managed PTF, net of allowance for impairment thereon, if any;

e. accounts receivables[9];

[9] Shall not include the accounts receivable against contributions or other underwriting activities, as the same relate to the PTF.

f. investment in associates and joint ventures;

g. investment in real estate;

h. investment in Sukuk (classified in line with the requirements of FAS 33 "Investments in Sukuk, Shares and similar instruments";

i. investment in shares and other securities;

j. property, plant and equipment with disclosure of significant types and related accumulated depreciation;

k. right of use assets;

l. intangible assets;

m. income tax (distinguishing between current and deferred) asset; and

n. other assets with disclosure of significant types.

B12 In case of assets financed through quasi-equity, the relevant disclosure requirements of FAS 1 "General Presentation and Disclosures in the Financial Statements of Islamic Financial Institutions" (Revised 2020) and FAS 27 "Investment Accounts" in respect of segregation and appropriate disclosure of assets financed by quasi-equity shall be followed.

Liabilities

B13 The following liabilities (pertaining only to the Takaful institution's owners) shall be presented as a minimum on the face of the statement of financial position or appropriately disclosed in the notes to the financial statements:

a. due to the managed PTF and managed PIF;

b. due to financial institutions;

c. due to other counterparties;

d. Sukuk – liability type;

e. gross ijarah liability, deferred Ijarah costs, and net Ijarah liability;

   i. provisions, accruals and other liabilities, including;

   ii. declared but undistributed profits;

   iii. Zakah obligation, distinguishing between legal and voluntary;

   iv. income taxes payable, distinguishing between current and deferred; and

   v. other payables.

Quasi-equity

B14 The following items related to quasi-equity shall be presented as a minimum on the face of the statement of financial or appropriately disclosed in the notes to the financial statements:

a. Sukuk;

b. financings based on Musharaka / Mudaraba; and

c. Investment accounts (or similar balances) [if applicable, meeting the definition of quasi-equity].

Owners' equity

B15 The following components of equity shall be presented as a minimum on the face of the statement of financial position or appropriately disclosed in the notes to the financial statements:

a. subscribed and paid-up capital;

b. premium on issued shares;

c. capital reserve, legal reserve and discretionary reserve;

d. retained earnings, duly identifying the amount of retained earnings resulting from the revaluation / fair value adjustment of assets and liabilities;

e. number of treasury shares held by the Takaful institution; and

f. any other component of owners' equity.

B16 Following disclosures shall be made in respect of the owners' equity:

a. authorized capital;

b. number of authorized, subscribed and paid-up shares (ownership units);

c. par value per share; and

d. any restrictions imposed on the distribution of retained earnings to owners.

Statement of income and other comprehensive income of the Takaful institution

B17 To the extent applicable, the following information shall be presented as a minimum on the face of the statement of income and other comprehensive income, or in notes to the financial statements:

a. Wakala fee and share of profits of the Takaful institution from the managed PTF and the managed PIF respectively, disclosing the manner in which the unearned contribution and Wakala fee is recognized;

b. income and gain from participatory investments and investments in shares and other securities;

c. income and gain from investments carried at fair value through statement of income;

d. income from off-balance-sheet assets under management other than the PTF and the PIF;

e. income from associates;

f. other fee, commission and related expenses;

g. other income;

h. general and administrative expenses, distinguishing between material expenses as separate line items;

i. net income (loss) before Zakah and taxes;

j. income taxes, both current and deferred, disclosed separately;

k. Zakah[10];

l. net income (loss); and

m. other comprehensive income

B18 The Zakah base and relevant reconciliation(s) shall be disclosed in line with requirements of the relevant FAS.

Statement of changes in owners' equity of the Takaful institution

B19 The statement of changes in equity shall appropriately reflect the opening and closing balances and the respective changes (or movement) during the period in the components of equity as enumerated in paragraph 21 and shall, in particular, present the following pertaining to the current financial reporting period:

a. capital contribution by the owners;

b. the net comprehensive income or loss, or alternatively net income or loss, and net other comprehensive income or loss, as applicable;

c. internal changes in components of equity e.g., issue of bonus shares or internal transfers between reserves and / or retained earnings;

d. distribution (dividends) to owners; and

e. Zakah paid (or recorded as payable) on behalf of the owners.

Statement of cash flows of the Takaful institution

B20 The Takaful institution shall disclose the net increase or decrease in cash and cash equivalents during the period and the balance of cash and cash equivalents at the beginning and end of the period.

[10] The legal liability shall be charged to the Statement of Income; other-than-legal obligations for Zakah are only to be disclosed in the notes. Where the shareholders have stipulated payment of Zakah in the articles of association / memorandum of the institution, the obligation will be charged to the owner's equity.

B21 The Takaful institution's policy with respect to the components of cash and cash equivalents used as a basis for the preparation of the statement of cash flows shall be disclosed.

B22 Appropriate disclosures shall be provided as a footnote the statement of cash flows, or in the notes to the financial statements, with regard to significant cash flows pertaining to PTF and PIF.

Statement of financial position of managed PTF

General considerations

B23 The following matters shall be considered while preparing the statement of financial position of managed PTF:

a. the statement of financial position of managed PTF shall include the PTF's assets, PTFs' liabilities, and the PTF's net assets;

b. participants' assets shall not be set-off[11] against participants' liabilities and participants' liabilities shall not be set-off against participants' assets, unless there is a specific requirement of a relevant FAS or a requirement of Shari'ah principles and rules or a legally enforceable right for the set-off;

c. significant items of participants' assets, participants' liabilities, and participants' fund shall not be combined on the face of the statement;

d. the amount of any allowance established to cover expected losses or amount of impairment shall be disclosed;

e. assets and liabilities shall be combined into groups, for better understanding, in accordance with their nature and shall be presented in the order of the relative liquidity of each group; and

f. sub-totals for participants' assets, participants' liabilities and participants' fund shall be disclosed.

Assets

B24 The following assets (pertaining only to the managed PTF) shall be presented as a minimum the face of the statement of financial position of managed PTF or appropriately disclosed in the notes to the financial statements:

a. cash and balances with Islamic banks and other financial institutions;

b. deposits with regulators, if any;

c. receivables from the Takaful institution, specifying the nature of the same;

d. contributions receivable, net of allowance for impairment thereon;

[11] [Explanation: Set-off is distinct from determining the net-PTF position]

e. receivables from re-Takaful, distinguishing between claims and commission receivable, net of allowances for impairment thereon;

f. other accounts receivables;

g. investments in real estate;

h. investment in Sukuk (classified in line with the requirements of FAS 33 "Investments in Sukuk, Shares and similar instruments");

i. investments in shares and other securities;

j. income tax asset (proportion related to the PTF), distinguishing between current and deferred, if any; and

k. other assets, with disclosure of significant types.

Liabilities

B25 The following liabilities (pertaining only to the managed PTF) shall be presented as a minimum on the face of the statement of financial position of managed PTF or appropriately disclosed in the notes to the financial statements:

a. due to the Takaful institution;

b. Qard-Hasan payable to the Takaful institution, and the significant terms and conditions including the expected period(s) of payment;

c. due to financial institutions;

d. due to other counterparties;

e. liabilities for incurred claims including the outstanding claims, and the claims incurred but not reported;

f. provisions for remaining coverage, including the technical provisions (including deferred contributions);

g. incurred claims and the remaining coverage related to re-Takaful institutions and other parties share of outstanding claims;

h. re-Takaful credit balance, including significant components thereof:

    i. provisions, accruals and other liabilities, including:

    i. declared but undistributed surplus;

    ii. income taxes payable (proportion related to the PTF), distinguishing between current and deferred; and

    iii. other payables.

B26 A reconciliation of the insurance contract balance, and the re-Takaful contract balances, for both the issued, and the held contracts shall be provided in a suitable manner.

Net assets of PTF

B27 The PTF's net assets (total asset less total liabilities) shall be presented on the face of the statement of financial position of managed PTF, duly disclosing the fund balance, accumulated deficit or and any undistributed surplus and any reserves maintained.

Statement of financial activities of managed PTF

B28 To the extent applicable, the following information shall be disclosed[12] on the face of the statement of financial activities of managed PTF, or in notes to the financial statements:

a. gross contributions;

b. Wakala fee and / or amortization of deferred Wakala fee;

c. re-Takaful share of contributions;

d. changes (or movement) in deferred contributions;

e. earned contributions for the financial period;

f. commission earned from re-Takaful for the financial period;

g. re-Takaful profit sharing commission of the previous financial periods;

h. gross claims paid;

i. re-Takaful share of gross claims paid;

j. other parties share of gross claims paid;

k. Takaful business acquisition cost;

l. changes in outstanding claims;

m. changes in re-Takaful share of outstanding claims;

n. provisions for outstanding court cases and ancillary matters;

o. income from investments, differentiating between:

p. income from Sukuk;

q. income from placements with Islamic banks and other financial institutions;

r. investments in shares and other securities;

[12] The presentation and disclosure may change according to the Takaful accounting model (general measurement model and the variable fee model).

s. fair value gains and losses on investments;

t. other income;

u. Qard-Hasan from the Takaful institution – written off during the period by the institution, considered Hiba, hence recorded as income of the participants' Takaful fund;

v. other expenses;

w. Wakala fee of the party managing Takaful operations;

x. remuneration of the party managing PTF;

y. income taxes, both current and deferred, disclosed separately; and

z. surplus or deficit resulting from technical operation.

B29 The statement of financial activities shall also disclose movement in the accumulated surplus or deficit[13]:

a. surplus or deficit balance at the beginning of the period;

b. surplus or deficit for the period;

c. gross surplus or deficit;

d. distributions of surplus to participants during the period; and

e. balance of surplus or deficit at the end of the financial period.

B30 The movement in profit equalization reserve, and the investment risk reserve, if any, shall be disclosed as part of the statement.

B31 The following matters shall be considered while preparing statement of financial activities of managed PTF:

a. the period covered by the statement of financial activities of managed PTF shall be disclosed;

b. contributions, expenses, gains and losses shall be disclosed at the portfolio level[14], indicating the underwriting year, and the profitability levels;

c. the nature of material contributions, expenses, gains and losses from other activities shall be disclosed; and

d. the basis of allocation of the surplus arising on the PTF and the PIF, and any other profit or gain attributable to them, amongst the participants.

[13] The presentation and disclosure may change according to the Takaful accounting model (general measurement model and the variable fee model).

[14] The Takaful institution may still be required to present geographical segments.

B32 Extent of non-compliant re-insurance arrangements and relevant transactions shall be disclosed in an appropriate manner including a summary of arrangements, justification, and the approval from the Shari'ah supervisory board (SSB) and any plans for replacement etc.

B33 Disclosures in respect of Shari'ah non-compliant income, relevant charity, and movement in charity fund shall be disclosed in line with the requirements of relevant FAS.

Statement of managed PIF

B34 The statement shall segregate managed assets by source (e.g., those from managed investment accounts, or investment units in managed investment portfolios). In addition, the statement shall segregate investment portfolios by type.

B35 The statement of managed PIF shall disclose the following:

a. the balance of managed assets at the beginning of the period with separate disclosure of the portion of the balance resulting from the revaluation of managed assets, where applicable;

b. the number of investment units in each of the investment portfolios and the value per unit at the beginning of the period, if applicable;

c. additional investments or purchase of investment units by the participants during the period, classified by type;

d. withdrawals of investment or repurchase of investment units by the participants during the period, distinguishing between policy cancellation, maturity and payment of benefits;

e. the institution's share in investment profits as a Mudarib or its fee as an investment agent;

f. direct expenses related to operations of the PIF e.g. acquisition costs for investment (if not considered element of the cost of investment), bank and legal charges and third-party management costs;

g. allocated overhead expenses, if any, from the Takaful institution to managed investment accounts or portfolios in line with Shari'ah principles and rules;

h. consolidated surplus or losses for managed assets during the period with separate disclosure of the amount resulting from the revaluation of managed assets, where applicable;

i. the consolidated balance of managed assets at the end of the period with separate disclosure of the portion of the balance resulting from the revaluation of managed assets, and any related impairment, where applicable;

j. movement in profit equalization reserve and / or investment risk reserve, or any other reserves, if applicable; and

k. the balance of managed assets at the beginning of the period with separate disclosure of the portion of the balance resulting from the revaluation of managed assets, where applicable.

B36 In case of investment fund having investment units, disclosure in terms of investment units (for each portfolio / plan) may also be considered useful for the users of financial statements, including disclosure of net income per unit and net asset value per unit at the beginning and the end of the period, in respect of each of the investment portfolios.

B37 The Takaful institution shall determine applicability of Zakah on the PIF in line with Shari'ah principles and rules. Where such an obligation is determined, it shall be disclosed appropriately, along with the Zakah base.

B38 Notes to the statement of managed PIF shall disclose the following:

a. the nature of the relationship between the Takaful institution and owners of the investments either as Mudarib or as investment agent along with significant terms and conditions of such arrangement; and

b. the rights and obligations associated with each type of investment account or investment unit.

B39 In rare cases, the managed PIF is based on unrestricted Mudaraba including the right of (and a practice of) comingling PIF with the institution's own funds. The rebuttable presumption is that such funds are under control of the Takaful institution, and hence, shall be presented on-balance sheet as quasi-equity, rather than being presented as off-balance sheet managed fund.

B40 Disclosures in respect of Shari'ah non-compliant income and relevant charity and movement in charity fund shall be disclosed in line with the requirements of relevant FAS.

Appendix C: Basis for conclusions

The reason for FAS on Takaful revision project

BC1 AAOIFI Financial Accounting Standards (FASs) FASs on Takaful were issued to prescribe the accounting treatments that were in line with the true nature of Takaful according to the AAOIFI Shari'ah Standards. AAOIFI issued four specific standards applicable to Takaful accounting and financial reporting i.e. FAS 12 "General Presentation and Disclosure in the Financial Statements of Islamic Insurance Companies", FAS 13 "Disclosure of Bases for Determining and Allocating Surplus or Deficit in Islamic Insurance Companies", FAS 15 "Provisions and Reserves in Islamic Insurance Companies" and FAS 19 "Contributions in Islamic Insurance Companies" between the years 1999 to 2003.

BC2 The AAOIFI Accounting Board (AAB / the board) monitored the developments in the Takaful industry and the considerable changes to the regulatory environment over the years, simultaneously taking account of the significant developments being made to the accounting best practices in the conventional insurance sector.

BC3 The board considered the question whether Takaful products may be faithfully reported by applying the recently issued international accounting standards on insurance, keeping in mind the specific Shari'ah implications. Conventional insurance is a risk trading business, whereas Takaful is based on risk sharing and Tabarru, whereby portions of contributions received from participants are treated as a donation into a common pool. The board concluded that due to the specific nature of Takaful, the accounting for conventional insurance was not suitable.

BC4 The AAOIFI strategy for development of financial accounting standards is to keep the AAOIFI FASs as close as possible to the global accounting standards, duly addressing the specific Shari'ah requirements. The board decided to use the same principle for revision of FASs on Takaful as the specific structure of Takaful is not catered to by the global standard setters.

BC5 The board has recently completed the project of revision of the "AAOIFI Conceptual Framework for Financial Reporting", where the fundamental accounting concepts applicable to various institutions and instruments have been standardized, and the revision of FAS 1 "General Presentation and Disclosure in the Financial Statements of Islamic Financial Institutions" is underway. Consequent to the revisions, it was considered essential to revise the standards for accounting and financial reporting for Takaful institutions as well.

The AAOIFI FAS on Takaful revision project output

BC6 The board agreed that the output of the Takaful project would be in the form of two exposure drafts, one related to the presentation and disclosure, and the other prescribing accounting treatments of Takaful. As the scope of the FAS 1 (Revised 2020) is enhanced to include all institutions, whether offering banking services or otherwise, the board decided not to duplicate the presentation and disclosure requirements that are already available in Part 1 of FAS 1 (Revised 2020) in this standard. Accordingly, this standard shall be read in conjunction with the requirements of FAS 1 (Revised 2020).

Scope and scope exclusions

BC7 The board considered its earlier decision of not issuing a separate interim reporting standard and proposed a specific scope exclusion to reduce the operational burden for Takaful institutions whereby this standard shall not apply to the structure and contents of condensed or summarized financial reports prepared for interim financial reporting. Further guidance is expected to be provided with the illustrative financial statements when issued.

Takaful and Islamic insurance

BC8 The board considered the terms 'Takaful' and 'Islamic insurance' as Takaful is commonly referred to as Islamic insurance, due to its apparent similarities. The previous AAOIFI FASs referred to both the terms interchangeably and the same are reflected in the AAOIFI SS on Takaful. In order to convey the true nature of the product and to standardize the terminology, the board concluded that the revised FASs will use the term 'Takaful institutions' and the term 'Islamic insurance' would not be applied. Similarly, the commonly used term 'premium' is to be abandoned and 'contributions from participants' is to be used instead. The collection of these contributions creates the Takaful fund. This distinction was agreed to be made in order to clearly distinguish Takaful from conventional insurance.

Takaful Institution and its operations

BC9 The board deliberated on the definition, structure and form of a Takaful institution, Takaful operator and the different funds. It was agreed that adequate and comprehensive definitions which were not provided for in the previous FASs such as Takaful, Takaful institution, Takaful operator, participants' (also referred to as policyholders') investment fund (PIF), and the participants' (also referred to as policyholders') Takaful fund (PTF) are to be introduced.

BC10 There are various models of Takaful prevalent in different jurisdictions. These primarily are based on Wakala Bi-Al Istithmar (investment agency), Mudaraba or a combination of both. In some cases, the policyholder are considered to be shareholders, and a Takaful operator runs the business on their behalf. In others, the legal framework does not allow this arrangement and the Takaful operator work must be established as separate entity on the basis of Mudaraba or Wakala. The board considered four of the most common models of Takaful used globally and decided to develop the standard on the Wakala model and Wakala-Waqf model as both are accepted by AAOIFI SS, whereas the Mudaraba model and cooperative model are not acceptable.

Accounting for the managed Takaful funds

BC11 The board agreed that the accounting for Takaful funds should be distinct from the Takaful institution (operator).

BC12 The PTF may be considered to be a virtual entity, like a virtual waqf entity or virtual sukuk entity. In most cases, the PTF is managed on behalf of others in a fiduciary capacity, but not controlled by the Takaful institution. The PTF is entitled to the contributions received from the participants and the related returns, provisions and reserves relating to the Takaful business, and the resultant surplus or deficit. The fund bears all direct expenses pertaining to management of the Takaful operations.

BC13 The relationship between the Takaful institution and the Takaful funds usually takes the form of a principal and agent relationship. Such relationships are required to be presented according to FAS

31 “Investment Agency (Al-Wakala Bi Al-Istithmar)” as off-balance-sheet assets under management. The board considered that although the Takaful institution has power, such power is exercisable in a fiduciary capacity as an agent only, and in its nature, does not result in variable returns to the institution itself. The board also agreed the risks and rewards with regard to the Takaful operations does not lie with the institution. The Takaful institution may be eligible to receive performance incentives in the capacity of the agent, being in a fiduciary capacity and these cannot be considered as variable returns as the Takaful institution is not exposed to risk of sharing a loss. It was concluded that such funds are considered to be off-balance-sheet assets under management, and therefore distinct from the Takaful institution.

BC14 It was also considered that a Takaful institution is not entitled to any surplus arising in the PTF. Where the PTF incurs a deficit, the Takaful institution may be obligated to temporarily support it through a Qard Hasan. The board agreed that the Qard-Hasan, by its very nature, is to be paid back to the Takaful institution, therefore it does not tantamount to entitlement of variable returns.

Windows

BC15 The board discussed that products offered through the Takaful window are principally different to conventional insurance products, therefore the contributions received by the Takaful fund cannot be presented as addition to the line item relating to premiums (collected in conventional insurance), during consolidation. It was agreed to prescribe a set of financial statements for the Takaful window separately, and to take the net figures taken to the consolidated accounts.

Definitions

BC16 The board observed that the global standard setters are using new terms related to insurance such as CSM (contractual service margin), risk adjustment, fulfilment cash flow etc. It was agreed that unless a clear Shari’ah objection is present, the same terms may be used by AAOIFI standards to foster familiarity with the contents of the financial statements.

BC17 The matter to use the term ‘participant’ or ‘policyholder’ was debated at the board. Members observed that the term ‘participant’ is indicative of investment fund accounting therefore not suitable. The board noted that both terms ‘participant’ and ‘policyholders’, were used interchangeably in AAOIFI SS. The board agreed that it must be made clear in the mind of a reader that Takaful is different than a ‘policy’ in conventional insurance, therefore, the term ‘participant’ would be more suitable than the conventional term ‘policyholder’.

Minimum components of the financial statements of a Takaful institution

Complete set of financial statements

BC18 Family Takaful and general Takaful are fundamentally different, and many countries do not allow a single company to engage in both. However, one parent company may control both the family and general Takaful operations, or a family Takaful company has a general Takaful as a subsidiary or vice versa. In such situations, the fund related to risk sharing is combined, however issues would arise if consolidation were performed of the Takaful fund surplus with deficit in the other fund. It may be beneficial for users if the two statements of financial activities of the Manage policyholders Takaful fund are presented.

Accounting for Qard Hasan

IN6 The board discussed that the AAOIFI SS clearly states that the Qard Hasan shall be refunded by the Takaful fund whenever it accrues a surplus. A Hiba is not allowed by Shari'ah however a Qard Hasan, on a temporary basis, is allowed with an understanding that it shall be returned after future surpluses as claims are paid by PTF. It was considered that when Qard Hasan is paid it is credit on the owners' fund / the Takaful operator accounts as cash and debit as receivable from policyholder Takaful fund. As Qard Hasan is a balance sheet item, the board concluded that impairment testing should be required in line with FAS 30 "Impairment, Credit Losses and Onerous Commitments"

Appendix D: Brief history of the preparation of the standard

H1 The newly formed AAOIFI Accounting Board (AAB) held its meeting No. 1 on 6-7 of Jumada II 1437H, corresponding to 15-16 of March 2016 at Ramee Grand Hotel, Kingdom of Bahrain. In this meeting it was decided a comprehensive revision of the existing AAOIFI FASs on Takaful is required.

H2 The first working group on the revised standard was held on 5 Rabi' I 1440H, corresponding to 13 November 2018 where the initial draft of the preliminary study was presented. In this meeting the scope and major changes required in the existing FAS in Takaful was discussed.

H3 The second working group meeting was held on 11 Rabi' II 1440H, corresponding to 18 December 2018. In this meeting members engaged in discussions and updates of newer requirements in international conventional comparable standards on Takaful / insurance.

H4 The third working group meeting was held on 12 Rajab 1440H, corresponding to 19 March 2019. In this meeting key areas of the revision project and deliverables were discussed.

H5 The fourth working group meeting was held on 26 Shawwal 1441H, corresponding to 18 June 2020. In this meeting the members discussed preliminary questions to be included in an industry-wide survey to gain input from important stakeholders and understanding of issues faced in different markets.

H6 The fifth working group meeting was held on 12 Safar 1442H, corresponding to 30 September 2020, where the first draft of the exposure draft on the revised standard on presentation and disclosures of Takaful institutions was presented.

H7 The sixth working group meeting was held on 22 Safar 1442H, corresponding to 10 October 2020 where the members continued discussions on the exposure draft.

H8 The seventh working group meeting was held on 7 Rabi' I 1442H, corresponding to 24 October 2020 where the second draft was discussed. Crucial decisions were made with regards to core principles to be incorporated.

H9 The eighth working group meeting was held on 19 Rabi' I 1442H, corresponding to 5 November 2020 where the third version of the draft was discussed. After making necessary changes the standard was recommended to the board.

H10 The draft standard was presented to the AAB in its meeting No. 21 held on 25 Rabi' I 1442H, corresponding to 11-12 November 2020. In this meeting the board reviewed the draft and recommendations made by the working group. After due deliberations, the exposure draft was approved for issuance.

H11 After incorporation of the board comments and an additional round of review via circulation by the working group, the exposure draft was issued on 13 Jumada II 1442H, corresponding to 26 January 2021.