

AN ASSESSMENT OF PROTECTION OF TAKAFUL PREMIUM AND SURPLUS IN MALAYSIA

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Abstract

With the growing interest on Islamic banking and finance, takāful as a concept is directly related to Islamic banking and finance; has been examined in different parts of world including Malaysia. However, there is no recent study assessing the protection of takāful premium and surplus in the context of Malaysia. The primary objective of this paper is to explore the protection of takāful premium and surplus in the country. The paper employs the qualitative content analysis. The findings indicated that there is a proper protection of takāful premium and surplus; nonetheless, in spite the fact that takāful had been in the market for more three decades, its penetration into market could not be compared with that of conventional insurance in the country. In addition, there are cases of takāful mismanagement in takāful industry in the country. It is further reiterated that, takāful mismanagement is a challenge to the financial stability of the takāful market. Also, mismanagement results in both reputation and financial damages as well as social and economic costs should be unreservedly addressed. In conclusion, protection of takāful premium and surplus in the context of Malaysia should be given ultimate concern. Lastly, it is suggested that loophole by different parties such as policy owners, third-party claimants, intermediaries and professionals who provide services to claimants in the transaction of takāful system that may cause the mismanagement should be addressed.

Keywords: Takāful, Premium, Surplus, Protection, Mismanagement

INTRODUCTION

In the world over, Islamic banking and finance has been growing among the researchers and promoters of Islamic financial system. Nowadays, there are over 300 financial institutions in over 75 countries across the world (Raimi, 2013). The growing body of knowledge since few decades had extensively explored various concepts of Islamic financial system.

Undoubtedly, the viability of Islamic financial system has been regarded an effective economic model in different part of the world. Various Islamic financial concepts such as *takāful* have been explicated in literature. According to Rusni (2011), *takāful* is a mutual and contractual guarantee or assurance which is provided by a group of people living in the same society against a defined-risk or catastrophe befalling life, property or any form of valuable asset.

Since risk is part and parcel of human life, seeking solution to various forms of risk enables insurance to provide service that would cater for handling properties.

Takāful as a concept directly related to Islamic banking and finance. Different Muslim and non-Muslim countries have considered Islamic banking and finance instrumental in

fostering economic development. Malaysia is one of Muslim countries that attach prime importance to the practical functionality of Islamic financial system. Thus, *takāful* has been examined in different parts of world including Malaysia. More importantly, *takāful* premium and surplus in Malaysia is an integral part of Islamic banking and finance that needs to be explored especially by protecting it from mismanagement.

In spite the fact that *takāful* has been in operation in Malaysia since more than three decades, *takāful* acceptance and penetration into market remains minutes as compared to conventional insurance. It should be reiterated that, there is less attention in the existing literature on the operation and application of *takāful*. In addition, the importance of *takāful* in addressing risks especially through the provision of insurance services is essential to be explicated upon. As a result, this paper explores the assessment of *takāful* premium and surplus in Malaysia.

CONCEPTUAL FRAMEWORK

This sub-section provides explicitly the conceptual framework of this paper with specific focus on the assessment of *takāful* especially with protection premiums and surplus against mismanagement or fraud. It is noteworthy to say that literature such as Rusni (2011) posits that, *takāful* is regarded as cooperative insurance with communal agreement of the participants with an exclusive motive of assisting each other. Undoubtedly, it is mutual assurance based on the principles of contract by a group of people against a defined-risk or catastrophe befalling life, property or any form of valuable asset. Similarly, *takāful* refers to guaranteeing each other against any calamities, disasters or injuries based on mutual commonality of people participating in *takāful* scheme.

Furthermore, in 1972, National Council for Islamic Religious Affairs in Malaysia issued fatwa that the conventional insurance was contrary to the dictate of Shariah because it involved different elements of uncertainty (Puteri and Khairuddin, 2013). In addition, in 1984, Islamic insurance known as *takāful* was introduced as an alternative to conventional insurance. In Malaysia, policy on *takāful* is meant to meet the needs of different categories of people such as individuals and corporate business bodies.

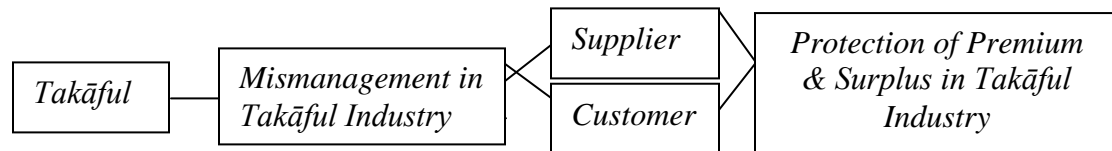
Onwards, it should be emphatically stressed that the existing loopholes in *takāful* industry in the context of Malaysia cover different aspects such as: operational risk, lack of many Shari'ah experts & Shari'ah compliant principle, lack of transparency in *takāful* contract, and lack of *takāful* understanding among agents and operators as literature explicates (Puteri and Khairuddin, 2013).

The abovementioned loopholes are further entrenched with manifestation of mismanagement of *takāful*. Indeed, mismanagement can be seen in the actions of some parties that gain financial advantages (Wells, 2011). Also, the Bank Negara Malaysia (2006) and all the *takāful* companies such as insurance companies' cooperation interpret mismanagement in *takāful* industry.

On one hand, mismanagement in the *takāful* industry manifested from the supplier which can be attributed to all parties, including *takāful* companies, participants and agents. On the other hand, the customer attempts to create fraudulent claim or making a falsified claim or customer overstates the amount of loss by inflating the value of the items taken through theft.

Addressing the challenges of mismanagement in *takāful* industry in Malaysia by the protecting premiums and surplus is paramount. In other words, there are many things to be put in place by the *takāful* company in order to prevent mismanagement so that the *takāful* company can function efficiently and effectively. Figure 1 below shows the conceptual framework of the paper.

Figure 1 Conceptual Framework



Source: Adapted from: (Bank Negara Malaysia, 2006; Rusni, 2011; Wells, 2011; Puteri and Khairuddin, 2013).

An Overview of Takāful Premium and Surplus in Malaysia

This section presents an overview of *takāful* from both linguistic and technical conceptions. Linguistically, *takāful* is an infinitive noun (*masdar*), derived from the Arabic word of “*kaff*”, which means guarantee or responsibility. Technically, *takāful* can be defined as a mutual guarantee or assurance based on the principles of contract (*‘aqd*), provided by a group of people living in the same society against a defined-risk or catastrophe befalling life, property or any form of valuable asset. Literature posits that, *takāful* is also known as cooperative insurance with mutual agreement of the participants with sole intention of helping one another (Rusni Hassan, 2011). In addition, *takāful* means guaranteeing each other against any calamities, disasters or injuries based on mutual co-operation and solidarity of people participating in *takāful* scheme.

Specifically, in the context of Malaysia, National Council for Islamic Religious Affairs issued fatwa in 1972 that the conventional insurance was contrary to the dictate of Shariah

because it involved different elements of uncertainty (Puteri and Khairuddin, 2013). Thus, there was an advocacy for Islamic compliant insurance which paved way for *takāful* or Islamic compliant insurance. Hence, *takāful* or Islamic compliant insurance undoubtedly prohibits uncertainty ascribed with the conventional insurance. This position has been shown further from the opinion of Muslim scholars that conventional insurance operates under certain uncertainties which are contrary to the dictates of Shariah as literature expounds. It is as a result of these uncertainties associated with conventional insurance that made the Fatwa Committee of the National Council for Islamic Religious Affairs Malaysia to issue a juristic verdict that conventional insurance is prohibited under the regulations of Shariah because it deals different elements of uncertainties such as interest or usury.

Onwards, it was in 1984 that Islamic insurance known as *takāful* was introduced as an alternative insurance. In Malaysia, policy on *takāful* is meant to meet the needs of different categories of people such as individuals and corporate business bodies. It should be reiterated that the Central Bank of Malaysia (2011) provides statistics on Annual *Takāful* which indicated that *takāful* has increased at the rate of 48.22% with specific amount of RM 6, 933 million specifically between 2007 and 2011 as literature expounds (Puteri and Khairuddin, 2013).

It is noteworthy to say that, Central Bank of Malaysia (2011) has shown that between 2007 and 2011, *takāful* has drastic proliferation of 47.41% with the rate of net income of 19.2 million. In spite of the growth of *takāful* industry in Malaysia, the general conventional insurance also experienced a meaningful rate of growth with specific net premium of RM106 million (22.32%) between 2007 and 2011 (Central Bank of Malaysia, 2011).

LOOPHOLES IN TAKĀFUL INDUSTRY IN MALAYSIA

As elucidated in literature that *takāful* has been in operation since more than three decades ago (Puteri and Khairuddin, 2013), the penetration of *takāful* into Malaysian market remains slower as compared to the conventional insurance in the country. This assertion might be as a result of loopholes in the *takāful* industry in the country. It should be reiterated that the existing loopholes in *takāful* industry in the context of Malaysia cover different aspects such as: operational risk, lack of many Sharī'ah experts & Sharī'ah compliant principle, lack of transparency in *takāful* contract, and lack of *takāful* understanding among agents and operators.

First, the main problem in *takāful* industry is operational risk whereby an additional cost could be regarded as a major challenge. This undoubtedly contributes immensely to the less application and procurement of *takāful* in the country.

Second, there are no many Sharī'ah experts in *takāful* industry in Malaysia, plus it is hard to follow Sharī'ah compliant principle. This position might be as a result of the fact that, there are

insufficient studies on Islamic finance that examine *takāful* in its fullest form specifically as an integral part of Islamic financial system as literature expounds (Puteri and Khairddin, 2013).

Third, lack of transparency in *takāful* contract can consequently emanate from competition with conventional insurance and it can also lead to profit making policy. For example, *takāful* companies responsible to represent true facts to their customers. However, in most cases, the agents are committed in getting customers for the company and most agents are driven to make more customers to get more commissions and premiums as promised by the company. In order to achieve this, agents tend to hide some facts from the customers even when they make an inquiry about it.

Fourth, lack of *takāful* understanding among agents and operators could be considered as one of major challenges facing *takāful* in Malaysia. It should be stressed that principal-agent relationship, most of the agents see it as profit making when *takāful* transaction supposed to be customer service. The company will be liable for any representation made by the agent. However, some agents are not trained by the *takāful* company or even do not have any knowledge about marketing and *takāful*.

As a result of this, the company here does not have any control towards its agents. The failure of the company in managing its agent may cost them if there is claim of misrepresentation by its agent. The company will be the only one that will be made liable and bear the consequences which not fully in accordance with *wakalah* concept of mutuality.

AN OVERVIEW OF MISMANAGEMENT IN TAKĀFUL INDUSTRY IN MALAYSIA

Undoubtedly, there are certain problems which lead to mismanagement in *takāful*. Generally, mismanagement can be determined by referring to the actions of some parties which enable them gain financial advantages (Wells, 2011). Specifically in Malaysia, the Bank Negara Malaysia (2006) and all the *takāful* companies together with insurance companies' cooperation provided an explanation that interprets mismanagement in *takāful* as seen below:

“Insurance mismanagement or *takāful* mismanagement is any deliberate deception or dishonesty committed against or by an insurance company or *takāful* operator, insurance or *takāful* agent, or consumer for unjustified financial gain. It occurs and may be committed at different points in the transaction by different parties such as policy owners, third-party claimants, intermediaries and professionals who provide services to claimants. The nature of these mismanagement may vary from an inflated/ exaggerated value of a legitimate claim to a completely fabricated or bogus claim where losses never really occurred”

Basically, it emphasizes on the parties that might be involved in the *takāful* mismanagement. Nonetheless, one of the most essential components that would declare it as mismanagement is when the deceiver intentionally perpetrates the insurance company or *takāful* operators, officer in a company or a third party. This would involve either financial or non-financial gain as the result of the deception.

Indeed, literature has linked deception or fraud with mismanagement. Deception or fraud in the economy sector has been demonstrated in the UK HM Treasury Fraud Report 1994-1995 as follows: “*Deception is being used with the intention of obtaining advantage, avoiding an obligation or causing loss to a third party*”.

The above definition has directly shown that fraud is more towards the economic advantages. This used to be practically demonstrated in a situation whereby somebody misuses his position and intentionally takes advantage of such position and causes loss to the other party.

Furthermore, mismanagement can occur when there is a conflict or negligence in the company in adhering to the Shari’ah principle. Similarly, mismanagement can happen in a situation where there is a professional risk management to take care of which consequently may lead the company to sacrifice one thing or the other as literature expounds (Isham Shafarin, Mohamad Haidir, Mohd Ashraf & Robiatul Adawiyah, 2014).

Onwards, in crisis and bad situation, majority of policyholders tend to claim from the company and the company tends to allocate minimum amount or even reject the claim by the policyholders. This will lead to insufficient portion of the contribution to the claim. Although, the issue of some policyholders get to claim more than what they paid, nevertheless, it could be considered unfair towards the company.

Thus, the situation is worse when the fund that is supposed to be allocated to the policyholders is paid to the agent as its commission for premiums. Hence, the agent who gets the client for the company in return of commission will not be liable to provide extra fund for the claim. This also happens to *takāful* based on investment and also the investment covered by the *takāful*. Undoubtedly, mismanagement in *takāful* industry can be specifically examined in relation to supplier and customer. Hence, the subsequently sub-headings elucidate on this.

Mismanagement by Takāful Supplier

This part explains mismanagement in the *takāful* industry with specific focus on the supplier. It can actually be attributed to all parties, including *takāful* companies, participants and agents. *Takāful* is perceived as cooperative insurance, where members contribute a certain amount of

money to a common pool. The purpose of this system is not profit making, but to uphold the principle of cooperation (The Islamic Insurance Co., 2015)

In managing the *takaful*, there are a lot of ethical, honest and trustworthy codes that *takāful* insurance agents and companies should be strictly adhered to but it cannot be denied that there are many crooked agents and bogus insurers. An agent may steal the consumer premiums by pocketing the insurance premiums instead of sending them to the insurers. These crooked agents may steal premium to support their own life. They sell to the consumers with fake coverage from a phony insurance company or sell bogus coverage using a name that's similar to a legitimate insurer or legitimate company's name. The consumer might receive an official-looking policy or proof of insurance that's worthless (Agent & Insurer Scam, 2015).

In other situation, the coverage may be real, but it tends to be expensive, unnecessary, and the current policy may already cover that risk. There can be made by churning, sliding and twisting. If an agent or broker is very aggressive and pressurizing a consumer which might convince people to use the built-up value of their current whole life policy to buy a "better" policy even though their present life coverage is perfectly suitable. By this way of mismanagement, the agent or broker gets a better commission, but consumer need to start building up cash value all over again.

Apart from that, an agent or insurer slips consumer extra coverage which the consumer does not ask for, but do pay for. This can easily add some or more to your premium. The agent cheerfully says it is simply part of a "package," or does not tell consumer about the coverage at all. For example, the most popular insurance policies that crooked agents sometimes sell to unwitting policyholders which are motor club memberships, accidental death coverage and guaranteed renewable life insurance. Then, they may urge supplier to change policies prematurely by "twisting" the truth about the downside.

Mismanagement by Customer

Mismanagement in *takāful* by the customer usually happened when engaging in activities such as situation when customers either pay the full price for purchased goods, or they get something for nothing, or they deceive an organization by giving them something that they should not have ordinarily acquired (Albrecht *et. al.*, 2011). Literature such as Tian & Keep (2002) asserted that customer mismanagement or fraud: ".....refers to an act or course of deception that is practiced by individuals against retailers or manufactures with a view towards gaining an advantages in the exchange that would not be available without covertly breaking the rules or norms of customers" exchange behaviour stabled by marketers."

The abovementioned expression is actually emphasizing on the action taken by the individual in creating advantages within the whole organization. This is the act of consequences from the intention of the general public to defraud back the organization. Besides that, it is applicable in the context of *takāful* organizations as most probably we can determine that users of a particular product or services are civilians who have their own interests (Adams, 2010).

For a public organization, such as general health care services, the customers as civilians with rigorous intention will be applying for their rights when using all public property equipment in their daily life (Jones, 2011). However, there are times when the motivation of the civilian is to overrule the systems for their own benefit (Herbert, 2005; Levi & Burrow, 2008). This describes customer fraud when the output of these activities is something that they are not supposed to have or accept, but by mistake this has been allocated when people use unlawful initiatives as just what happened is to benefit from fraud (Dronberger, 2003; O'Donnel *et. al.*, 2007).

According to Insurance information produced by Bank Nagara Malaysia (BNM) in Malaysia, it has classified the groups of *takāful* fraud by customer into some categories as circulated to all insurers in the country. Firstly, the customer attempt to create fraudulent claim or making a falsified claim for instance they wrongly claim for personal accidents in the case of self-inflicted injuries and at the worst part they even make a faking death for benefit or filling death claims. Besides that, providing wrong facts in order to receive payments is also one of the most common things they did. Undeniably, customer will usually claim for total disability or partial disability for a minor or unserious injury. Secondly, the fraudulent action can be seen when the customer overstating amount of loss where they tend to inflate value of the items taken during a burglary or theft (Bank Negara Malaysia, 2006). This position is also supported from documentation by the Association of British Insurers (ABI) 2011.

The Impact of Mismanagement and Protection against Loss and Damage in Takāful Industry

The consequence of the mismanagement of the *takāful* is the financial damage. The fraud will certainly give impact to the person or organization that has financial interest in the company. The company may lose money, and consequently it will also affect the other company's customers which ultimately make up for those loses and it will affect the company to run its activities or businesses. Similarly, it will also affect the participants of the *takāful* in such a way that they may lose their large sum of money which may not have been risked if the participants are aware of the true financial situation of that particular company (Coenan, 2011).

More so, the mismanagement of *takāful* funds will affect the society. As part of the consequences, the people in the society may become unreliable and dishonest. It can also create a wall in the industry between the society and any *takāful* company or operator as the society will be reluctant to involve in the *takāful* industry because of the bad perception or impression regarding the risk to contribute funds in this industry.

Further still, the company insurance or *takāful* is regarded as one of the financial institutions which is an organized body involved with the money management. In other words, the *takāful* company is responsible for the funds that they get from the members or participants in the *takāful* policy where they contribute their money into *takāful* system to guarantee each other against loss and damage. The principle of *takāful* is based on shared contribution to help those who are in need.

Normally, the *takāful* company or *takāful* operator needs to maintain two separate accounts, which are one for the shareholders' rights and liabilities and the other one for the rights and liabilities of the participants or policyholders as literature expounds (AAOIFI, 2007; Islamic Financial Services Board, 2009). Similarly, it can also be regarded as all funds paid by *takāful* participants whereby the funds are credited into the specific accounts for participants which are commonly known as the Participants' Risk Fund (PRF). The *takāful* company has no rights or power to the money credited and given by the participants in that account.

So, if the *takāful* company failed to maintain the two accounts separately, this may create chances to mismanagement of the funds. If there is mismanagement of the funds given by the members it will affect the reputation of the *takāful* company itself. The insurers will not have a good image in front of the participants (Feinman, 2010).

SUGGESTIONS IN SOLVING THE PROBLEMS OF MISMANAGEMENT IN TAKĀFUL

This part provides different suggestions in addressing the challenges of mismanagement in *takāful* industry in the context of Malaysia specifically towards the protection of premiums and surplus. In other words, there are so many things that need to be done by the *takāful* company in order to prevent or at least minimize the mismanagement so that the company can avoid losses and the policyholder also may claim their money when they needed it. A number of suggestions are provided as follows:

First, policyholders also have liability to disclose facts and not falsehood. In an attempt to present false information, this consequently may cause the company to suffer loss. There are cases where the policyholders tend to be fraudulent in claim in order to get money. The company therefore will need to hire investigator or even have its own investigation department in order to prevent loss.

Second, the customer or client must beware of every *takāful* agent since there are many unregistered *takāful* agents. Before applying to buy any *takāful* product, the customer need to call the *takāful* operator company that the agent said he is working with or call the Malaysian *Takāful* Association (MTA) to ensure that the agent is a registered *takāful* agent.

Third, the customer can pay the premium through cheque, Internet banking or money delivery to the *takāful* company or the *takāful* operator instead of paying directly to the agent. It is thereby reiterated that the customer needs to feel suspicious if the price or the premium of the *takāful* offered by an agent is lower compared to the standard price or premium in other *takāful* companies.

Fourth, accident on the road is one of the situations where people always become the victim of fraud. After involved in an accident, people need to be careful with anyone that might be part of fraud syndicate, especially if they want the client to go to specific workshop to repair the car, specific medical clinic for treating the injury, or specific law firm in order to take legal action for the accident.

Fifth, if the customer already becomes the victim of the mismanagement in *takāful* or is being persuaded by the agent to involve in *takāful* mismanagement, they are thereby advised to make a report to the *takāful* company or operator and also in police station so that the police will catch the culprit.

Sixth, there is need for initiative pertaining to public awareness campaign to educate citizens of Malaysia about the mismanagement of *takāful*, so that they will get information and awareness regarding mismanagement of *takāful*, the severity of the crime, and also its potential risks and effect, in order to avoid themselves from committing offence relating to mismanagement of *takāful* and to prevent themselves from being the victim of the mismanagement of *takāful*.

Seventh, mismanagement happens when there is a conflict in the company to follow the Shariah principles. So, the *takāful* companies are bound to ensure they are following the Shariah principles. The *takāful* companies must also show that they have serious awareness to prevent the risk of mismanagement of the *takāful* to their participants or customers.

Eighth, the government of Malaysia can create a website such as ISO ClaimSearch in order to improve claim processing and prevent fraud. The function of ISO ClaimSearch is to collect data from various insurance companies and other organizations into a single database that can be used to investigate claims by insurer. When a claim was submitted by the insurer, ISO ClaimSearch will then search for matches by details such as name or similar name, address, vehicle identification number, driver's license number, and reports on other claims filed by same individuals or businesses. Thus, the claim patterns can be identified. Besides that, ISO

ClaimSearch has system to model for suspected fraud through its own claim scoring system. If the government of Malaysia can create effective system like this and implement it effectively and efficiently, there is high possibility that mismanagement of *takāful* especially in terms of fraud can be prevented.

Ninth, honest customers should not pay the funds for the crooked *takāful* agents or companies through higher premiums. It is elucidated that the *takāful* industry must continue to strengthen its control and systems and do whatever possible way to overcome the issue of mismanagement of *takāful* premium and surplus and therefore it can minimize the cost of mismanagement to insurers and the impact on honest participants or customers.

Tenth, loophole by different parties such as policy owners, third-party claimants, intermediaries and professionals who provide services to claimants in the transaction of *takāful* system that may cause the mismanagement should be addressed

CONCLUSION

This paper has lucidly explicated on the paramount importance of protecting *takāful* premiums in the context of Malaysia. The paper has explained the linguistic and technical conceptions of *takāful* whereby the opinions of Muslim scholars that conventional insurance operates under certain uncertainties which are contrary to the dictates of Shari'ah. Various loopholes such as: operational risk, lack of many Shari'ah experts & Shari'ah compliant principle, lack of transparency in *takāful* contract, and lack of *takāful* understanding among agents and operators are explicitly elaborated. Also, mismanagement in *takāful* with specific focus on suppliers and customers are explained. It is noted that detecting and countering mismanagement in *takāful* is an essential step that needs to be taken to provide protection to the insurers and the *takāful* companies. Finally, further studies should be focused on empirical study on protection of Takaful premium and surplus in Malaysia where *takaful* companies, policy maker, premium payer, expert, jurists, and scholars should be interviewed in other to have additional facts that were not documented.

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