# African Reinsurance Corporation (South Africa) Limited

**Financial Statements**

**for the year ended 31 December 2005**

# African Reinsurance Corporation (South Africa) Limited

(Reg. No. 2003/031630/06)

## Financial Statements

*for the year ended 31 December 2005*

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## Declaration by company secretary

In our capacity as Company Secretary, we hereby confirm and certify, in terms of the Companies Act, 1973, as amended, that for the year ended 31 December 2005, the Company has lodged with the Registrar of Companies all such returns as are required of a public company in terms of this Act and that all such returns are true, correct and up to date.

______________________

Levitt Kirson Management Services CC
Secretary

16 March 2006

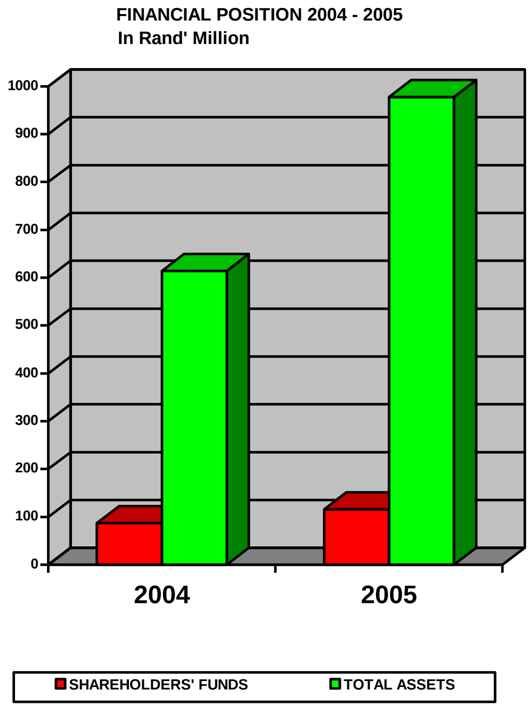
# African Reinsurance Corporation (South Africa) Limited

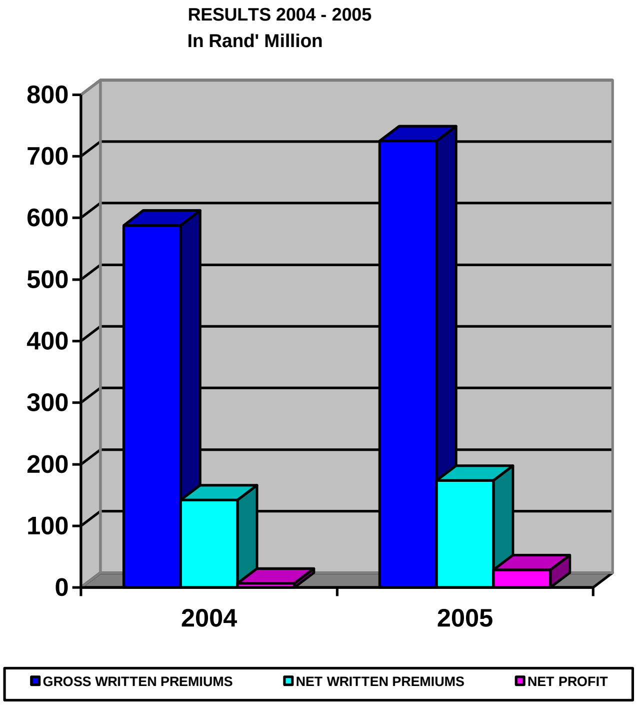
## Financial Highlights

*for the year ended 31 December 2005*

| In R'000 | 2005 | 2004 |
|---|---|---|
| **RESULTS** | | |
| GROSS WRITTEN PREMIUMS | 725 005 | 587 940 |
| NET WRITTEN PREMIUMS | 173 859 | 142 154 |
| NET EARNED PREMIUMS | 166 756 | 114 205 |
| NET PROFIT | 28 899 | 6 922 |
| **FINANCIAL POSITION** | | |
| SHAREHOLDERS' FUNDS | 116 121 | 87 222 |
| TOTAL ASSETS | 977 804 | 614 089 |
| INTERNATIONAL SOLVENCY MARGIN[N1] | 62% | 55% |

[N1] International solvency margin is calculated as the non-life net assets expressed as a percentage of the non-life net written premium.



# African Reinsurance Corporation (South Africa) Limited

## Chairman and Executive Management Statement

*for the year ended 31 December 2005*

The period ended 31 December 2005 saw the completion of African Reinsurance Corporation (South Africa) Limited's ("Africa Re (SA)" or "the Company") second year of operation.

During the course of the year, the company's non-life insurance licence was extended to include miscellaneous business thus giving it the ability to write all classes of non-life insurance business.

At the fifth meeting of the Board of Directors held in July 2005, the Board took a decision to cease writing life business thus allowing management the opportunity to further build upon the already well established non-life account.

The year under review saw a return of a relatively large number of "frequency" losses although the severity remained fairly low by previous year's levels. The company experienced a number of weather related losses, the severity of which also remained within manageable levels.

Despite these losses, the company has posted results above original expectations in its second year of operation. The company had a positive second year of operation and has reported impressive written premiums and underwriting results.

Gross written premiums for the period under review is R725.0 million compared to R587.9 million recorded in 2004 representing a 23.3% increase over that recorded in the previous year. The main growth in written premiums was recorded in the non-life business which grew by 24.3% from R571.0 million in 2004 to R709.4 million in 2005. Life business recorded a 7.7% decrease in written premiums from R17.0 million in 2004 to R15.7 million in 2005 following the company's decision to stop writing life business and to focus on the non-life business portfolio.

Underwriting profit for the period is R9.4 million compared to an underwriting loss of R1.6 million reported in 2004 which represents a significant improvement. The decrease in the combined ratio from 101% in 2004 to 94% in 2005 helped to improve the underwriting results for the year. Management expenses for the year under review were R16.7 million.

Net investment income for the period is R30.9 million compared to R10.8 million recorded in 2004 representing an increase of 186.1%. The impressive investment income for the year under review is mainly due to an increase in cash flows and strong performance of the equity portfolio due to the strong bull-run of the Johannesburg Stock Exchange market during 2005, especially towards the end of the year.

Accrued income tax expense charged to the income statement for the period is R11.4 million (2004: R2.3 million) resulting in an after tax profit of R28.9 million compared to R6.9 million in 2004.

We firmly believe that given the current strength of the South African economy and predicted continued growth in gross domestic product, and with it's total commitment to the local market, Africa Re (SA) will continue to show steady and controlled, positive growth, employing prudent underwriting principles whilst searching for opportunities to develop long term partnerships with our select clients.

Our sincere thanks go to all of our valued partners in both the life and non-life markets and in particular to our fellow Directors who continue to assist with the development of the South African subsidiary.

There were no changes to the Board of Directors who met three times during the course of the financial year ended 31 December 2005. These meetings were attended by all directors as detailed below:

B H Kamara (Chairman)
P D Ray (Managing Director)
G Musa (Non-Executive Director)
A F W Peters (Non-Executive Director)

Specific responsibilities have been passed by the Board of Directors onto the Audit Committee and that committee, under the chairmanship of A F W Peters, met three times during the course of the financial year just completed.

Also in attendance at these meetings were Messrs. G Musa (Director/Member), P D Ray and G Waweru of Africa Re (SA) together with both the internal and external auditors.

Africa Re (SA) continues to take an active, yet small role in the promotion of Corporate Social Responsibility and in this regard, various donations were made to worthy organisations during the course of 2005. The Company will continue to develop this activity into the future and will identify worthy causes which will benefit both groups and individuals in the fields of education, training and health initiatives.

Our employees continue to be our most important asset and we believe that each and every member has contributed towards the success in the development of Africa Re (SA). We continue to develop an environment where each employee is able to reach their potential and to share in the success of our business.

In this regard, Africa Re (SA) will continue to strive to attract and retain the very best people focussing on the right rewards and incentives whilst allowing staff to create a balance between both personal and professional capabilities.

To all our staff who continue to give of their best proving commitment to the company, we wish to extend sincere thanks for all their valued efforts.

| | |
|---|---|
| **Bakary H Kamara** | **Paul D Ray** |
| **Chairman** | **Managing Director** |

# African Reinsurance Corporation (South Africa) Limited

## Directors' Responsibility for the Financial Statements

*for the year ended 31 December 2005*

The directors are responsible for monitoring the preparation, integrity and fair presentation of the financial statements and related information included in the report of African Reinsurance Corporation (South Africa) Limited. The financial statements of the company have been prepared in accordance with International Financial Reporting Standards (IFRSs) and its interpretations issued by the International Accounting Standard Board (IASB) and the requirements of the South African Companies Act.

The preparation of financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses at the date of the financial statements and the reporting period. The estimates and associated assumptions are based on historical experience and management's best knowledge of current events. These are believed to be reasonable under the circumstances and as a result actual results may differ from those estimates.

In order for the board to discharge its responsibilities, management has developed and continues to maintain a system of internal controls. The directors are responsible for the company's system of internal controls and review its operation, primarily through the audit and risk-monitoring committee.

The internal controls include a risk-based system of internal accounting and administrative controls designed to:

- provide reasonable but not absolute assurance of accuracy and reliability of the financial statements;
- ensure that the company's assets are adequately safeguarded and transactions are executed and recorded in accordance with business practices and the company's policies and procedures; and
- prevent and detect misstatements and losses.

These controls are implemented by trained skilled personnel and are monitored by management and include a comprehensive budgeting and reporting system operating within strict deadlines and an appropriate control framework.

The directors have no reason to believe that the company will not be a going concern in the foreseeable future and the financial statements have been prepared on the going concern basis.

The financial statements for the period ended 31 December 2005, as set out on pages 10 to 46 were approved by the board of directors on 16 March 2006 and are signed on its behalf by:

| | |
|---|---|
| **B H Kamara** | **P D Ray** |
| **Chairman** | **Managing Director** |

# African Reinsurance Corporation (South Africa) Limited

## Statement of Actuarial Values and Liabilities

*for the year ended 31 December 2005*

**Statement of assets, liabilities, excess assets and capital requirements**

| | 2005<br>R'000 | 2004<br>R'000 |
|---|---:|---:|
| Total assets as per balance sheet | 21 654 | 18 545 |
| Adjustment to fair value | Nil | Nil |
| Less intangible assets | Nil | Nil |
| Value of adjusted assets | 21 654 | 18 545 |
| Current and other liabilities as per balance sheet | 10 014 | 6 197 |
| Net assets | 11 640 | 12 348 |
| Actuarial value of gross policy liabilities | 234 | 1 446 |
| Excess Assets | 11 406 | 10 902 |
| Capital adequacy requirement (CAR) | 10 000 | 10 000 |
| Ratio of Excess Assets to CAR | 1.14 | 1.09 |

The change in excess assets from the start of the year is shown below.

| Description | 2005<br>R'000 | 2004<br>R'000 |
|---|---:|---:|
| Surplus at start of year | 10 902 | Nil |
| Adjustment to Capital | Nil | 10 300 |
| Expense Experience | 223 | Nil |
| Mortality Experience | (318) | 79 |
| Interest Received | 641 | 783 |
| Tax Paid | (42) | (260) |
| Surplus at end of the year | 11 406 | 10 902 |

**1. Valuation methodology**

The valuation was performed using the Financial Soundness Valuation method and was conducted in accordance with PGN104. Assets and policy liabilities have been valued on methods and assumptions that are consistent with each other.

This financial soundness valuation gives a statement of the financial position of a life insurance company.

## Statement of Actuarial Values and Liabilities

*for the year ended 31 December 2005 (continued)*

All actuarial liabilities were calculated gross of reinsurance, as the portion retroceded as approved reinsurance with African Reinsurance Corporation (Nigeria) is held as an asset on the balance sheet of Africa Re (SA). The following details the liabilities that were calculated.

- For the Life and Disability Quota Share, Mulitprotect Quota Share and Credit Protection Quota Share treaties, Prosperity has relieved Africa Re (SA) from all liability under this contract. As a result, there were no reserves raised for these policies.
- Regent Life also provided Africa Re (SA) with a declaration that releases the Company from all outstanding liabilities under the Catastrophe Excess of Loss treaty. Again, no reserves were raised for this treaty.
- For all other treaties a liability was calculated for claims that have occurred, but have not yet been reported (IBNR). As a result of a lack of past experience, I assumed an ultimate claims ratio (after allowing for reinsurance commission and brokerage) of 92.5% for all lines of business.
- For the portion of the premiums that relate to future contractual risks appropriate liabilities were established for the Catastrophe Excess of Loss treaties with Prosperity Insurance and NBC Holdings. Premiums are paid upfront for the full term of the contract. Both of these contracts have duration of 12 months. I have assumed that the risk is spread uniformly over the 12 month period. The Prosperity contract has three months, and the NBC Holdings treaty two months of unexpired risk. A unearned premium reserve (UPR) of three twelfths for Prosperity and two twelfths for NBC Holdings of the annual premium was raised.
- Both of these treaties pay an initial expense of 10% in brokerage fees. This implies that the whole of the annual premium is not earned uniformly over the year. A DAC asset equal to ten percent of the UPR value was raised as an offset for the non-linear incidence of brokerage.
- All other premiums are received on a monthly basis and require no UPR.

### 2. Valuation of assets

Assets were valued at balance sheet values, i.e. market or fair value, as per the accounting policies in the financial statements.

### 3. Valuation of policy liabilities

*Composition of policy liabilities*

The policy liabilities have the following composition:

| Treaty | Proportion of total 2005 | 2004 |
|---|---|---|
| Life and Disability Quota Share | Nil | 68.22% |
| Mulitprotect Quota Share | Nil | 10.36% |
| Credit Protection Quota Share | Nil | 1.31% |
| Longsmith Excess of Loss Treaty | 33.56% | 14.69% |
| Longsmith Disability Quota Share | 20.80% | 5.42% |
| Facultative Quota Share Treaty | 19.20% | Nil |
| Catastrophe Excess of Loss Treaties | 26.44% | Nil |
| **Total** | **100.00%** | **100.00%** |

**4. Changes in valuation basis**

The methodology and assumptions used to value the liabilities have remained broadly the same as those applied as at 31 December 2004.

**5. Capital Adequacy Requirement**

The capital adequacy requirement is the additional amount required, over and above the actuarial liabilities, to provide for future experience that is more adverse than that assumed in the calculation of policyholder liabilities. This additional amount is as required by the Long-term Insurance Act, 1998 and is in accordance with PGN104 of ASSA.

The volume and nature of the business written by Africa Re (SA) is such that it does not warrant additional capital to be held in excess of the prescribed (PGN104) minimum of R10 000 000.

The ratio of free assets to the capital adequacy requirement is 1.14 times.

**6. Report by the Statutory Actuary**

I hereby certify that:

The actuarial valuation of African Reinsurance Corporation (South Africa) Limited as at 31 December 2005, the results of which are summarised above, has been conducted in accordance with, the Long-term Insurance Act, 1998, and the Actuarial Society of South Africa's professional guidance note 104.

This Statutory Actuary's report has been produced in accordance with the Actuarial Society of South Africa's professional guidance note 103.

This Statutory Actuary's Report, read together with the annual financial statements, fairly represents the financial position of the company.

The life insurance fund of African Reinsurance Corporation (South Africa) Limited was financially sound as at the valuation date.

D S Nohr, FIA FASSA
Statutory Actuary
16 March 2006

## Report of the Independent Auditors

**To the member of African Reinsurance Corporation (South Africa) Limited**

We have audited the annual financial statements of African Reinsurance Corporation (South Africa) Limited as set out on pages 10 to 46 for the year ended 31 December 2005. These financial statements are the responsibility of the company's directors. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements present fairly, in all material respects the financial position of the company as of 31 December 2005, and the results of its operations and its cash flows for the year then ended in accordance with International Financial Reporting Standards, and the Companies Act in South Africa.

**KPMG Inc.**
*Registered Auditors*
*Chartered Accountants (SA)*
16 March 2006

# African Reinsurance Corporation (South Africa) Limited

## Directors' Report

*for the year ended 31 December 2005*

The directors are pleased to present the directors' report that forms part of the financial statements of the company for the year ended 31 December 2005.

**Business**

The business of the company is that of a professional reinsurer for short-term and long-term reinsurance business.

**Share capital**

The authorised and issued share capital of the company including share premium is R80.3 million. The issued share capital comprises of seven ordinary shares of R0.01 each of which one share was issued at a premium of R80.3 million.

**Balance sheet**

The company's shareholders funds represented by share capital and share premium, statutory contingency reserve and retained earnings as at 31 December 2005 amount to R116.1 million (2004: R87.2 million). Net technical liabilities under insurance contracts at 31 December 2005 amount to R95.5 million (2004: R64.1 million).

**Income statement**

Profit after taxation for the year is R28.9 million (2004: R6.9 million). The results for year are presented in the accompanying income statement and notes to the accounts and require no further amplification.

**Holding company**

The company is a wholly owned subsidiary of African Reinsurance Corporation established under the auspices of the African Union with its headquarters in Nigeria.

**Dividend**

This being the second year of operation for the company, the directors do not propose payment of a dividend. As in the previous period, surplus income will be retained to strengthen the company's reserves.

**Directors**

The directors who served the company during the year were:

| | |
|---|---|
| Bakary Kamara | Non-executive chairman (Mauritanian) |
| Paul D Ray | Executive director |
| Allan Peters | Non-executive independent director (British) |
| Ganiyu Musa | Non-executive director (Nigerian) |

**Secretary**

Levitt Kirson Management Services CC
Registration No. 1994/036439/23

4th Floor, Aloe Grove
196 Louis Botha Avenue,
Houghton Estate, 2198

PO Box 1523
Johannesburg
2000

**Auditors**

Messrs KPMG Inc. were appointed the statutory auditors of the company and have expressed their willingness to continue in office.

# African Reinsurance Corporation (South Africa) Limited

## Balance Sheet
*at 31 December 2005*

| | Note | 2005 R'000 | 2004 R'000 |
|---|---|---|---|
| **Assets** | | | |
| Equipment | *6* | **760** | 636 |
| Intangible assets | *7* | **44** | 42 |
| Financial assets | *8* | **542 280** | 223 962 |
| - Fixed deposits | | **404 096** | 156 584 |
| - Equities and bonds | | **138 184** | 67 378 |
| Technical assets under insurance contracts | *9* | **338 672** | 220 894 |
| - Retroceded outstanding claims reserve | | **198 216** | 113 787 |
| - Retroceded unearned premium reserve | | **105 156** | 83 846 |
| - Deferred acquisition costs | | **35 126** | 22 176 |
| - Retroceded life policyholders' liability | | **174** | 1 085 |
| Amounts due from companies on reinsurance accounts | *10* | **66 293** | 111 072 |
| Deposits retained by ceding companies | *11* | **3 601** | 30 138 |
| Amount due from holding company | | **-** | 798 |
| Accounts receivable | *12* | **6 828** | 992 |
| Cash and cash equivalents | *13* | **19 326** | 25 555 |
| **Total assets** | | **977 804** | 614 089 |
| **Liabilities** | | | |
| Technical liabilities under insurance contracts | *9* | **434 198** | 285 001 |
| - Gross outstanding claims reserve | | **264 287** | 151 716 |
| - Gross unearned premium reserve | | **140 208** | 111 795 |
| - Deferred retrocession commission revenue | | **29 470** | 20 044 |
| - Gross life policyholders' liability | | **233** | 1 446 |
| Amounts due to companies on reinsurance accounts | *14* | **104 143** | - |
| Deposits due to retrocessionaire | *15* | **293 052** | 231 255 |
| Amount due to holding company | | **14 749** | - |
| Other provisions and accruals | *16* | **3 238** | 8 637 |
| Deferred tax liability | *17* | **4 654** | 427 |
| Current income tax liability | *18* | **7 649** | 1 547 |
| **Total liabilities** | | **861 683** | 526 867 |
| **Net assets** | | **116 121** | 87 222 |
| **Shareholders' equity** | | | |
| Share capital and share premium | *19* | **80 300** | 80 300 |
| Contingency reserve | *20* | **17 010** | 13 808 |
| Retained earnings /(accumulated loss) | | **18 811** | (6 886) |
| **Total shareholders' equity** | | **116 121** | 87 222 |

# African Reinsurance Corporation (South Africa) Limited

## Income Statement

*for the year ended 31 December 2005*

| | *Note* | **2005 R'000** | 2004 R'000 |
|---|---|---|---|
| **Income** | | | |
| Net earned premiums from non-life insurance contracts | *21* | **162 997** | 110 133 |
| Net earned premiums from life insurance contracts | *22* | **3 759** | 4 072 |
| Commission received | *23* | **155 940** | 91 131 |
| Transfer from policyholder's liabilities on life insurance contracts | *22* | **302** | - |
| Net investment income | *24* | **30 912** | 10 754 |
| **Income from operations** | | **353 910** | 216 090 |
| Net claims incurred on non-life insurance contracts | *21* | **111 303** | 91 663 |
| Net claims incurred on life insurance contracts | *22* | **3 107** | 2 629 |
| Transfer to policyholder's liabilities on life insurance contracts | *22* | **-** | 361 |
| Commission paid | *23* | **182 491** | 101 851 |
| Management expenses | | **16 673** | 10 384 |
| **Profit before taxation** | *25* | **40 336** | 9 202 |
| Taxation | *26* | **11 437** | 2 280 |
| **Profit for the year / period** | | **28 899** | 6 922 |

# African Reinsurance Corporation (South Africa) Limited

## Statement of Changes in Equity

*for the year ended 31 December 2005*

| | Share capital and share premium R'000 | Contingency reserve R'000 | Accumulated (loss)/retained earnings R'000 | Total R'000 |
|---|---|---|---|---|
| Share capital subscription | 80 300 | | | 80 300 |
| Profit for the period | | | 6 922 | 6 922 |
| Transfer to contingency reserve | | 13 808 | (13 808) | |
| **Balance as at 31 December 2004** | **80 300** | **13 808** | **(6 886)** | **87 222** |
| Profit for the year | | | **28 899** | **28 899** |
| Transfer to contingency reserve | | **3 202** | **(3 202)** | |
| **Balance as at 31 December 2005** | **80 300** | **17 010** | **18 811** | **116 121** |

## African Reinsurance Corporation (South Africa) Limited

### Cash Flow Statement

*for the year ended 31 December 2005*

| | *Note* | **2005 R'000** | 2004 R'000 |
|---|---|---|---|
| **Cash generated by operations** | *32.1* | **282 700** | 159 607 |
| Interest paid | | **(12 912)** | (2 437) |
| Taxation paid | *32.2* | **(1 108)** | (306) |
| **Net cash inflows from operating activities** | | **268 680** | 156 864 |
| **Cash flows from investment activities** | | | |
| Net purchase of equipment and intangibles | | **(415)** | (838) |
| Net purchase of investments | | **(302 703)** | (221 051) |
| Interest received net of investment management fees | | **26 426** | 10 134 |
| Dividends received | | **1 783** | 146 |
| **Net cash outflow from investment activities** | | **(274 909)** | (211 609) |
| **Cash flow from financing activities** | | | |
| Proceeds from share subscription | | **-** | 80 300 |
| **Net (decrease) / increase in cash and cash equivalents** | | **(6 229)** | 25 555 |
| **Cash and cash equivalents at the beginning of the year** | | **25 555** | - |
| **Cash and cash equivalents at the end of the year** | | **19 326** | 25 555 |

## Notes to the Financial Statements
*for the year ended 31 December 2005*

### 1. General information

African Reinsurance Corporation (South Africa) Limited is a professional reinsurer underwriting both life and non-life insurance risks in the domestic and regional markets. The company is a public company incorporated and domiciled in the Republic of South Africa. The company is a wholly owned subsidiary of African Reinsurance Corporation.

The financial statements were authorised for issue by the directors on 16 March 2006.

### 2. Accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all the periods presented, unless otherwise stated.

### (a) Statement of compliance

The financial statements of the company have been prepared in accordance with International Financial Reporting Standards (IFRSs) and its interpretations issued by the International Accounting Standard Board (IASB).These are the company's first IFRS financial statements and IFRS 1 has been adopted and applied in their preparation. The company's year end is 31 December and it publishes comparative information for one year. The effective date of transition to IFRS is therefore 1 January 2004.The impact of the transition to IFRS on the financial position of the company is presented in note 3.

### (b) Basis for preparation

The financial statements are prepared in South African Rand rounded to the nearest thousand. They are prepared on the historical cost basis except for financial assets and liabilities that are stated at fair value or amortised costs and policyholder liabilities that are disclosed at the financial soundness value.

The preparation of financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts of assets, liabilities, income and expenses at the date of the financial statements and the reporting period. The estimates and associated assumptions are based on historical experience and management's best knowledge of current events. These are believed to be reasonable under the circumstances and as a result actual results may differ from those estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis to take account of new and available information. Revisions to accounting estimates are recognised in the year in which the estimate is revised if the revision affects only that year, or in the year of revision and future years if the revision affects current and future years.

**2. Accounting policies** *(continued)*

**(c) Classification of contracts**

Contracts under which the company accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or other beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder or other beneficiary are classified as insurance contracts. Insurance risk is other than financial risk. Financial risk is the risk of a possible future change in one or more of a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. Insurance contracts may also transfer financial risk.

**(d) Recognition and measurement of insurance contracts**

Non-life and life insurance business is accounted for on an annual basis.

**Non-life insurance premiums**

Written premium income comprises premiums on contracts entered into during the year, irrespective of whether they relate in whole or in part to a later accounting period. Premiums are disclosed gross of acquisition costs payable to intermediaries and other third parties and is accounted for net of value added taxation. Premiums written for the period also include adjustments to premiums written in prior accounting periods and estimates for pipeline or premium not yet advised by the insured for contracts in force at the end of the period. Premiums are earned from the date of attachment of risk, over the indemnity period, based on the pattern of risks underwritten. Premium relating to the expired risk period is recognised as revenue for the period while premium relating to the unexpired risk period is recognised as a provision for unearned premium. The outward retrocession premiums relating to earned premiums are recognised as an expense in accordance with the retrocession services received.

**Unearned premiums provision for non-life insurance contracts**

The portion of gross written premiums on non-life insurance contracts which is estimated to be earned in the following or subsequent years is recognised as an unearned premium provision. This is computed separately for each contract at the balance sheet date using principally the one-over-eighth basis for treaty business and the 50% basis for facultative business. Where the nature of the underlying business and risk does not justify the use of the above methods, the unearned premium reserve is calculated on bases relevant to the risk profile of the insurance contract.

## Notes to the Financial Statements

*for the year ended 31 December 2005 (continued)*

**2. Accounting policies** *(continued)*

(d) **Recognition and measurement on of insurance contracts** *(continued)*

**Claims arising from non-life insurance contracts**

Claims incurred in respect of non-life insurance contracts consist of claims and claims handling expenses paid during the financial year and movements in provision for outstanding claims.

Outstanding claims comprise provisions for all the company's estimated ultimate costs of settling all claims incurred but unpaid at the balance sheet date whether reported or not and related claim handling expenses. Outstanding claims that have occurred at the balance sheet date and have been notified to the company by the cedants are carried at the claim amounts advised by the cedants. Adequate provisions are also made for claims incurred at the balance sheet date, but not reported at the balance sheet date using historical experience and best available information. Outstanding claim provisions are disclosed at their carrying amounts except where there is a particularly long period from the claim incident to settlement in which case outstanding claims are discounted using a discount rate that best reflects current assessment of time value of money and associated risks. Anticipated retrocession recoveries on claims are disclosed separately as assets.

Whist the directors and management considers that the gross provision for outstanding claims liabilities and the related retrocession recoveries are fairly stated on the basis of information currently available to them at the balance sheet date, the ultimate claim liability may vary as a result of subsequent events and information and may result in significant adjustments to the amount provided. Adjustments to the amounts of claims provision established in prior years are reflected in the financial statements for the period in which the adjustments are made, and disclosed separately if material. The methods used to determine the estimates and the estimates made are reviewed regularly to take into account new information to arrive at the most accurate estimates at the time of reporting.

**Unexpired risk provision for non-life insurance contracts**

Where the expected value of claims liabilities and expenses attributable to the unexpired periods of the insurance contracts in force at the balance sheet date exceed the unearned premium provision relating to those contracts after deduction of any deferred costs, provision is made for unexpired risk liabilities for the estimated excess liabilities.

**2. Accounting policies** *(continued)*

**Claims and policyholder liabilities arising from life insurance contracts**

Claims incurred in respect of life insurance contracts consist of claims arising during the year. Outstanding claims on life insurance contracts that have occurred at the balance sheet date and have been notified to the company by the cedants are carried at the claim amounts advised by the cedants.

Policyholder liabilities under life insurance contracts are valued in terms of the Financial Soundness Valuation (”FSV”) basis contained in PGN104 issued by the Actuarial Society of South Africa and are reflected as “Policyholder liabilities under life insurance contracts” in the balance sheet. The operating surpluses or losses arising from insurance contracts are determined by the annual actuarial valuation. These surpluses or losses are arrived at after taking into account the movement in actuarial liabilities under unmatured policies, provisions for profit commissions accrued and adjustments to contingency and other reserves within the policyholder liabilities. Anticipated retrocession recoveries under retrocession agreements are disclosed separately as assets.

**Liability adequacy test**

At each balance sheet date, liability adequacy tests are performed to ensure the adequacy of the contract liabilities net of related deferred acquisition costs. In performing these tests, current best estimates of future contractual cash flows and claims handling and administration expenses, as well as investment income from the assets backing such liabilities are used. Any deficiency is immediately charged to profit or loss initially by writing off deferred acquisition cost and by subsequently establishing a provision for losses arising from liability adequacy tests (unexpired risk provision as referred to above).

**Reinsurance contracts and assets**

The company buys reinsurance cover in the normal course of business through retrocession contracts for the purpose of limiting its net potential loss through the diversification of its risks. Retrocession arrangements do not relieve the company from its direct obligation to its cedants. Amounts recoverable under retrocession arrangements are assessed at each balance sheet date. These assets are deemed impaired if there is objective evidence, as a result of an event that occurred subsequent to its initial recognition, that the company may not recover all amounts due and that the event has a reliably measurable impact on the amounts that the company will receive from the retrocessionaire. The carrying amounts of the assets are reduced by the impairment losses and the impairment losses are recognised in the profit and loss account for the period.

Premiums retroceded and benefits reimbursed in respect of retrocession contracts are disclosed in the income statement and balance sheet on a gross basis. Amounts recoverable under the retrocession contracts are recognised in the same year as the related claims. Contracts that do not transfer significant insurance risk are recorded using the deposit method of accounting.

**2. Accounting policies** *(continued)*

**(d) Recognition and measurement of insurance contracts** *(continued)*

**Reinsurance contracts and assets** *(continued)*

Retrocession assets include balances due from the retrocessionaires for ceded insurance business. Premiums on reinsurance assumed are recognised as revenue and accounted as if the reinsurance was considered direct business, taking into account the product classification of the reinsured business. Amounts recoverable from retrocessionaires are estimated in a manner consistent with the amounts associated with the reinsured insurance contracts and in accordance with the terms of each retrocession contract.

**Deferred acquisition costs**

The costs of acquiring new and renewed insurance business that is primarily related to the production of that business are deferred.

Acquisition costs comprise insurance commissions, brokerage and other related expenses arising from the conclusion of insurance contracts.

In respect of non-life insurance the proportion of acquisition costs that correspond to the unearned premiums are deferred and amortised on a pro rata basis over the contract term. For life contracts, deferred acquisition costs are amortised in proportion to the anticipated premiums. Assumptions of anticipated premiums are made at the inception or acquisition of the contracts and are consistently applied over the expected duration of the contracts.

**Commission income**

Commission received or receivable which do not require the company to render further service are recognised as revenue by the company on the effective commencement or renewal dates of the related policies. However, when it is probable that the company will be required to render further services during the life of the policy, the commission, or part thereof, is deferred and recognised as revenue over the year during which the policy is in force.

**(e) Contingency reserve**

A contingency reserve is provided for in terms of the Short-term Insurance Act, 1998, and represents 10% of gross non-life insurance premiums written less approved reinsurance (as defined in the Act). The reserve is treated as a separate component of shareholders equity in the balance sheet and transfers to or from the reserve as an appropriation in the statement of changes in equity. The reserve may be utilised only with the prior permission of the Registrar of Short-term Insurance.

**(f) Operating lease payment**

Payments made under operating leases are recognised in the income statement on a straight-line basis over the lease period.

**2. Accounting policies** *(continued)*

**(g) Employee benefit under defined contribution plan**

The company contributes to a defined contribution pension plan for all its employees. The company's obligations for the contributions to the defined contribution pension plan for its employees are recognised as an expense in the income statement as incurred.

**(h) Foreign currencies transactions**

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to Rand at the exchange rate ruling at the balance sheet date. Foreign exchange differences arising on translations are recognised in the income statement in the period in which the difference occurs.

**(i) Equipment**

Equipment is stated at cost less accumulated depreciation and impairment losses. Depreciation is calculated and charged to the income statement on a straight-line basis over the estimated useful life of each item of equipment. The estimated useful lives of each category of equipment are as follows:

| | |
|---|---|
| Motor vehicles | 4 years |
| Computer equipment | 3 years |
| Furniture and fittings | 8 years |
| Office equipment | 3 years |

The residual value and useful life, if not insignificant, is reassessed annually. Where the carrying amount of an asset is greater than its estimated recoverable amount, impairment losses are recognised to write down the value of the asset to its recoverable amount.

Gains and losses on disposal of fixed assets are determined by reference to their carrying amounts at the date of sale and are recognised in the income statement.

**(j) Intangible assets**

Intangible assets consist of purchased software. Intangible assets are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to the income statement on a straight-line basis over the estimated useful life of intangible assets. The useful life is reviewed annually.

**(k) Financial instruments**

**Investments**

The company's investments are classified into the following categories, depending on the purpose for which the assets were acquired:

Financial instruments at fair value through profit or loss, are financial assets which on initial recognition are designated by the company as being at fair value through profit or loss. The company's listed equity and fixed income investments are classified as financial instruments through profit or loss.

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the company has positive intention and ability to hold to maturity.

**2. Accounting policies** *(continued)*

**(k) Financial instruments** *(continued)*

**Investments** *(continued)*

Purchases of financial instruments are recognised on the trade date, which is when the company commits to purchase the assets. Financial instruments are derecognised when contractual rights to receive cash flows from the assets expire, or where the assets, together with substantially all the risks and rewards of ownership have been transferred.

Financial instruments are initially measured at fair values plus, in the case of financial instruments not at fair value through profit or loss, transaction costs that are directly attributable to their acquisition. After initial recognition the company measures financial instruments at fair values without any deduction for transaction costs that it may incur on disposal.

A financial asset is derecognised when the company loses control over the contractual rights that comprise the asset and consequently transfers the substantive risks and benefits associated with the asset on trade date. This occurs when the rights are realised, expire or are surrendered. A financial liability is derecognised when it is legally extinguished.

The fair value of quoted financial assets is their quoted bid price at the balance sheet date. Held-to-maturity financial assets are measured at amortised cost using the effective interest rate method, less impairment losses.

Realised gains and losses, and unrealised gains and losses arising from changes in the fair value of financial assets at fair value through profit or loss, are included in the profit or loss in the period in which they arise. Where the financial assets are interest-bearing, interest calculated using the current market or effective interest rate method is recognised in profit or loss.

**Other receivables**

Trade and other receivables and deposits retained by ceding companies are stated at amortised cost net of impairment for any amounts expected to be irrecoverable.

**Trade and other payables**

Trade and other payables are stated at amortised cost.

**Deposits retained on reinsurance ceded**

Deposits retained on reinsurance ceded are stated at amortised cost.

**Cash and cash equivalents**

Cash and cash equivalents comprise cash balances and call deposits and are measured at fair value.

**2. Accounting policies** *(continued)*

**(l) Impairment**

The carrying amounts of the company's assets are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the carrying value of the asset is reduced to the estimated recoverable amount by means of an impairment charge to the income statement. The recoverable amount is the higher of its net selling price and its value in use.

In assessing value in use, the expected future cash flows from the asset are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

A previously recognised impairment loss is reversed if the recoverable amount increases as a result of a change in the estimates used to determine the recoverable amount, but not to an amount higher than the carrying amount that would have been determined (net of depreciation) had no impairment loss been recognised in prior years.

**(m) Provisions**

A provision is recognised in the balance sheet when the company has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation.

**(n) Taxation**

Income tax on the profit or loss for the period includes South African normal tax both current and deferred tax. Normal income and deferred taxes are determined using taxation rates that have been enacted or substantively enacted by the balance sheet date.

Current tax is the expected tax payable on the taxable profit for the year and any adjustment to tax payable in respect of previous years

Deferred tax is provided in full, using the balance sheet liability method, providing for all temporary differences between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. Tax rates enacted or substantively enacted at the balance sheet date are used to determine deferred tax.

Deferred tax assets are recognised for tax losses carried forward only to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilised. Deferred tax assets and liabilities are not discounted.

**(o) Comparative figures**

Where necessary comparative figures have been reclassified.

### 3. Explanation of transition to IFRS

As stated in the accounting policies above, these are the company's first financial statements prepared in accordance with IFRS.

The accounting policies set out above have been applied in preparing the financial statements for the year ended 31 December 2005 and the comparative information presented in these financial statements for the period ended 31 December 2004. The company only started to operate in 2004. Therefore there is no opening balance sheet at the date of transition to IFRS, being 1 January 2004.

Except for the accounting policies relating to the treatment of operating lease payments, insurance contracts and property, plant and equipment, the company has applied the same accounting policies as those applied in the previous GAAP. The adoption of the above accounting polices have not had any impact on profit and loss or equity previously reported.

### 4. Accounting estimates and judgements

Management discussed with the audit committee the development, selection and disclosure of the company's critical accounting policies, estimation methods and the application of these policies and estimation methods.

The critical accounting judgements and assumptions used in applying the company's accounting policies are described below:

**Policyholder claims for non-life insurance contracts**

The company's estimates for reported and unreported losses and the resulting provisions and related retrocession recoverables are reviewed and updated regularly to take into account new information to determine the most accurate estimates at the time of reporting. Adjustments resulting from this review are reported in the income statement in the period the adjustments are made. The process relies on the basic assumption that past experience adjusted for effects of current developments and likely trends, is an appropriate basis for predicting future events. Due to the limited past experience for the company, the assumptions provide for a conservative view in estimating unreported losses. Estimation of claims provision is a complex process and significant uncertainty exists as to the ultimate settlement of claim liabilities.

**Policyholder claims for life insurance contracts**

The company estimates for reported and unreported losses and the resulting provisions and related retrocession recoverables are based on past experience. The process relies on the basic assumption that past experience adjusted for effects of current developments and likely trends, is an appropriate basis for predicting future events.

**4. Accounting estimates and judgements** *(continued)*

Limited data was available to derive statistical characteristics of claims development and due to the short period the business was in force, the application of statistical techniques to derive the future policyholder liabilities was not possible.

Information received directly from the cedants in respect of the remaining treaties in force, was used to determine the incurred but not reported (IBNR) loss reserves. Where this information was not obtained, the IBNR reserves were calculated assuming an ultimate claims ratio. An unearned premium reserve has only been raised where open periods of risk remain.

**Estimates**

As a result of the time delay experienced by reinsurers in the receipt of bordereaux or treaty accounts statements from their cedants, they are required to estimate insurance results where bordereaux or treaty accounts statements have not yet been received.

In the calculation of these estimates, cognisance is taken of the past performance of the treaty adjusted by the relevant current information.

**5. Risk management objectives and policies**

**(a) General**

African Reinsurance Corporation (South Africa) Limited ("Africa Re (SA)") is licensed to write all classes of insurance business as stipulated in the Short-term Insurance Act, 1998, and the Long-term Insurance Act, 1998, except for health and fund business.

**Non-life insurance contracts**

Africa Re (SA) underwrites non-life business both on a treaty and facultative basis in all classes of business, but mainly concentrates in the property and motor sectors where cover is provided to protect the insured's material property and possible business interruption following such loss events. The most significant portion of the business is written on a treaty basis. These risks are accepted proportionally and non-proportionally.

Africa Re (SA) continues to strive towards writing a balanced account across all classes but limits its exposure to business of a long-tail nature thus avoiding the uncertainty regarding claims provisions for long-tail business. Most of the losses on the business written by Africa Re (SA) are expected to be reported within a fairly short period and as a result the bulk of the business underwritten by the company is regarded as being short-tail in nature.

The return to the stakeholders under non-life products arise from the difference between total premium income generated from cedants less amounts reserved and paid in respect of claims and expenses incurred by the company. There is also the possibility that the shareholder may earn income from the investment of the premium income but as losses are reported within a fairly short period, such income is limited in respect of short-tail business.

**5. Risk management objectives and policies** *(continued)*

**(a) General** *(continued)*

**Life insurance contracts**

There are only nine life treaties in force as at the end of the financial year. The risks assumed under these treaties include disability, life and credit protection cover. Risks were accepted on a quota share and excess of loss basis.

Following a decision taken at Board level, the company has stopped writing life business with effect from July 2005. As at 31 December 2005 most of the life treaties have expired and liability on those treaties have been extinguished through portfolio transfers and agreements with the cedants leaving gross outstanding policyholder liabilities amounting to R233,000.

**(b) Insurance risk management objectives and policies for mitigating risks**

The key insurance risks faced by Africa Re (SA) are underwriting risks relating to premium pricing adequacy, negative claims development or reserves risk, event exposure and concentration risk and, reinsurance risk.

**Premium pricing adequacy risk**

This is the risk that premiums relating to current and past periods business will not be sufficient to fund liabilities arising from that business. With regards to the adequacy of premiums, Africa Re (SA) determines the appropriateness of the rates and/or premiums charged by the leading office by carefully examining past experience with market practice, rates and the company's return expectations. Africa Re (SA) does not accept or underwrite risks where the premiums are not considered adequate or commensurate to the risk.

Africa Re (SA) makes underwriting decisions in accordance with the group's underwriting guidelines. These guidelines set the criteria for assessing insurance risk before acceptance and approval levels for underwriting decisions. Compliance with the groups underwriting guidelines is verified through periodic audits by the group's Directorate of Central Operations and Inspection which in turn reports its findings to both Executive Management and the Audit Committee.

**5. Risk management objectives and policies** *(continued)*

**(b) Insurance risk management objectives and policies for mitigating risks** *(continued)*

**Event exposure and concentration risk**

Africa Re (SA) is exposed to large or catastrophic losses and loss accumulation from single loss events. The largest exposure to significant losses to Africa Re (SA) relates to losses arising from catastrophic events such as floods and earthquakes. In this regard, Africa Re (SA) has identified that the greatest likelihood of a loss of this nature would result from an earthquake in the Gauteng region. Using international modelling tools, Africa Re (SA) has established that its exposure to a loss of this nature is limited to a one-in-three hundred-year event.

The group underwriting guidelines set the criteria for assessing insurance risk and exposure limits for single and portfolio risks before acceptance. In order to further minimise the insurance exposure risk to the company's net results, Africa Re (SA) has a retrocession arrangement with its holding company which provides protection above the net retention of Africa Re (SA) up to the group limits. This is then further protected under the group retrocession programme which is largely placed into the international and Lloyds markets.

**Claims development or reserves risk**

This is the risk that actual ultimate claims costs will be significantly different from the estimated outstanding claims.

The determination of reserves for the ultimate claims costs is done with reference to previous year's data and past experience, adjusted with the information and data available at the time of reporting. Although these assumptions and estimation bases are based on management's best judgement and information available at the time of reporting, estimation of claims provision is a complex process and the ultimate claims settlement costs may differ from these estimates.

To reduce the risk of inadequate reserving, the company takes a conservative view in estimating unreported losses due to the limited past experience.

**Policyholder liabilities reserves risk**

This is the risk that the ultimate actual policyholder liabilities under life insurance contracts will be significantly different from the estimated policyholder liabilities and the established reserves will not be adequate to cover these costs.

Due to the fact that the life operations are in run-off this risk is limited to the treaties where there are still unsettled and unreported loss events. In most cases these risks have been transferred back to the cedant by means of a portfolio transfer and the gross policyholder liabilities have been valued at R233 000. This risk is further mitigated by the 75% retrocession agreement with the holding company, limiting the company's net exposure to R58 000.

As a result of the company not continuing to underwrite life business there is no exposure to any lapse risk and to a very limited degree to interest rate risk on the assets backing the policyholder liabilities.

**5. Risk management objectives and policies** *(continued)*

**Insurance risk management objectives and policies for mitigating risks** *(continued)*

**Reinsurance risk**

The company retrocedes insurance risk to limit exposure to underwriting losses and accumulation of losses through proportional and excess of losses or stop loss cover agreements. These retrocession agreements spread the risk and minimise the effect of losses.

Under the terms of the retrocession agreements, the retrocessionaire agrees to reimburse their share of paid claims and acquisition costs. However, the company remains liable to its cedants with respect to retroceded insurance liabilities if the retrocessionaire fails to meet the obligations it assumes. This is a credit risk and as noted under the credit risk section, the retrocessionaire's shares of insurance liabilities are fully secured by deposits held by the company or bank guarantee in accordance with the regulatory solvency requirements and the retrocession agreement.

**(c) Financial risk management objectives and policies for mitigating risks**

Transactions in financial instruments may result in the company assuming financial risks. These include market risk, interest rate risk, credit risk, liquidity risk and reinsurance risk. Each of these financial risks is described below, together with a summary of the ways in which the company manages these risks.

**Market price risk**

Market risk can be described as the risk of change in fair value of a financial instrument due to changes in market conditions and prices of these instruments. The company is exposed to market price risk through fluctuation of the value of financial instruments due to changes in their market prices. Investments in marketable securities are valued at fair value and are therefore susceptible to changes in market prices.

Africa Re (SA) conducts a sensitivity analysis on the effect of changes in market prices of its equity investment to determine the maximum risk it can tolerate without adversely affecting its operating performance and financial situation, and this, together with the investment guidelines determine the proportion of funds to be invested in equity instruments. The company does not make use of financial instruments to manage this risk. The maximum market price risk is limited to investments held in marketable securities.

**5. Risk management objectives and policies** *(continued)*

**(c) Financial risk management objectives and policies for mitigating risks** *(continued)*

**Credit risk**

The company has exposure to credit risk, which is the risk that a counterparty will be unable to pay amounts in full when due. The key areas where the company is exposed to credit risk are:

- retrocessionaire’s share of insurance liabilities;
- balances due from insurers and retrocessionaires;
- amounts due from insurance contract intermediaries; and
- investment instruments held with financial institutions.

Retrocessionaire’s shares of insurance liabilities are fully secured by a combination of deposits withheld by the company and bank guarantees obtained from local banks. This is in accordance with the regulatory solvency requirements and the retrocession agreement.

Management has a credit policy in place where balances due from cedants and retrocessionaires are monitored on an ongoing basis. There has been no default on settlement of balances due from cedants and retrocessionaires.

The fixed income investments held by the company are issued by the South African government and are considered secure. Reputable financial institutions are used for investing and cash handling purposes within the company's strict guidelines on investment instruments and institution exposures limits and the probability of default is expected to be extremely low.

At balance sheet date there were no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying value of each financial asset in the balance sheet.

**Asset/liability matching**

A distinction is drawn between insurance and shareholders' funds. The overall philosophy governing the investment of insurance funds is driven by liquidity considerations and a strong emphasis on capital preservation. Most of the company’s investments are held in readily realisable investments in line with the short-tail nature of the company’s business. The maturity profile of investments will approximate the average term of operational liabilities.

**Interest rate risk**

Fluctuations in interest rates impact on the value of and cash flows from interest bearing assets and liabilities. The company has no borrowings. Interest rate risk exposure is therefore limited to the company's investments in fixed interest rate instruments such as fixed deposits and bonds.

Other than ensuring optimum money market rates for deposits, the company does not make use of financial instruments to manage this risk.

**5. Risk management objectives and policies** *(continued)*

**(c) Financial risk management objectives and policies for mitigating risks** *(continued)*

**Liquidity risk**

The company is exposed to daily cash payment calls on its available cash resources arising mainly from claims. Liquidity risk is the risk that cash may not be available to pay obligations when due at a reasonable cost. The company has set limits on the minimum proportions of assets held as short-term investment and limits on the minimum proportions maturing funds available to meet such cash payment calls and unexpected levels of demand.

**Currency exchange risk**

Most of the company's transactions are in Rand which is the presentation currency. All assets and liabilities are held in Rand and the company is not exposed to any significant currency exchange risk.

| 6. **Equipment** | **2005 R'000** | 2004 R'000 |
|---|---|---|
| **Cost** | | |
| Motor vehicles | **565** | 405 |
| Computer equipment | **269** | 152 |
| Office equipment | **65** | 41 |
| Furniture & fittings | **272** | 183 |
| | **1 171** | 781 |
| **Accumulated depreciation** | | |
| Motor vehicles | **217** | 76 |
| Computer equipment | **114** | 38 |
| Office equipment | **30** | 11 |
| Furniture & fittings | **50** | 20 |
| | **411** | 145 |
| **Carrying values** | | |
| Motor vehicles | **348** | 329 |
| Computer equipment | **155** | 114 |
| Office equipment | **35** | 30 |
| Furniture & fittings | **222** | 163 |
| | **760** | 636 |
| **Reconciliation of carrying values** | | |
| Opening balance | **636** | - |
| Additions | **390** | 782 |
| Disposals | **-** | (1) |
| Depreciation | **(266)** | (145) |
| Closing balance | **760** | 636 |

| | | 2005 R'000 | 2004 R'000 |
|---|---|---|---|
| **6.** | **Equipment** *(continued)* | | |
| | **Motor vehicles** | | |
| | Net carrying value at beginning of year | **329** | - |
| | Additions | **160** | 405 |
| | Depreciation | **(141)** | (76) |
| | Net carrying value at end of year | **348** | 329 |
| | **Computer equipment** | | |
| | Net carrying value at beginning of year | **114** | - |
| | Additions | **117** | 152 |
| | Depreciation | **(76)** | (38) |
| | Net carrying value at end of year | **155** | 114 |
| | **Office equipment** | | |
| | Net carrying value at beginning of year | **30** | - |
| | Additions | **24** | 41 |
| | Depreciation | **(19)** | (11) |
| | Net carrying value at end of year | **35** | 30 |
| | **Furniture & fittings** | | |
| | Net carrying value at beginning of year | **163** | - |
| | Additions | **89** | 184 |
| | Disposals | **-** | (1) |
| | Depreciation | **(30)** | (20) |
| | Net carrying value at end of year | **222** | 163 |
| **7.** | **Intangible assets** | | |
| | **Computer software** | | |
| | **Cost** | | |
| | Opening balance | **57** | - |
| | Acquisitions - purchased | **25** | 57 |
| | Closing balance | **82** | 57 |
| | **Accumulated amortisation** | | |
| | Opening balance | **15** | - |
| | Amortisation – software in use | **23** | 15 |
| | Closing Balance | **38** | 15 |
| | **Carrying value** | **44** | 42 |

### 8. Financial assets

| | **2005 R'000** | 2004 R'000 |
|---|---|---|
| Held-to-maturity instruments at amortised cost | | |
| Fixed deposits | | |
| – non-life | **383 259** | 150 528 |
| – life | **20 837** | 6 056 |
| | **404 096** | 156 584 |
| Instruments at fair value through profit and loss | | |
| Listed | | |
| – bonds (non-life) | **83 723** | 32 849 |
| – equities (non-life) | **54 461** | 34 529 |
| | **138 184** | 67 378 |
| | **542 280** | 223 962 |

**Cost of instruments disclosed at fair value through profit and loss**

| | **2005 R'000** | 2004 R'000 |
|---|---|---|
| Bonds | **83 373** | 32 031 |
| Equities | **38 590** | 32 475 |
| | **121 963** | 64 506 |

Presented below are the maturity profiles and interest rate exposures of the company's interest bearing investments.

| **Maturity period** | **Effective interest Rate %** | **Market value R'000** |
|---|---|---|
| **At 31 December 2005** | | |
| Within 1 year | 7.00% to 7.34% | **404 096** |
| 1 to 3 years | 7.32% to 8.51% | **11 574** |
| 3 to 7 years | 7.81% to 8.24% | **69 326** |
| 7 to 12 years | 7.61% | **2 823** |
| | | **487 819** |
| **At 31 December 2004** | | |
| Within 1 year | 7.25% to 7.50% | 156 584 |
| 1 to 3 years | 7.47% to 7.86% | 12 494 |
| 3 to 5 years | 7.82% to 8.04% | 20 355 |
| | | 189 433 |

| 9. Technical assets and liabilities under insurance contracts | **2005 R'000** | 2004 R'000 |
|---|---|---|
| **Technical liabilities** | | |
| *Non-life insurance contracts* | | |
| -Gross claims reported but not yet settled | **161 683** | 74 157 |
| -Gross claims incurred but not reported | **102 604** | 77 215 |
| -Gross unearned premium provision | **140 208** | 111 795 |
| -Deferred retrocession commission revenue | **29 470** | 20 044 |
| | **433 965** | 283 211 |
| *Life insurance contracts* | | |
| -Gross claims reported but not yet settled | **-** | 344 |
| -Gross policyholders liability | **233** | 1 446 |
| | **233** | 1 790 |
| **Total technical liabilities** | **434 198** | 285 001 |
| **Technical assets** | | |
| *Non-life insurance contracts* | | |
| -Retrocessionaire's share of claims reported but not yet settled | **121 263** | 55 618 |
| -Retrocessionaire's share of claims incurred but not reported | **76 953** | 57 911 |
| -Retrocessionaire's share of unearned premium provision | **105 156** | 83 846 |
| -Deferred acquisition costs | **35 126** | 22 176 |
| | **338 498** | 219 551 |
| *Life insurance contracts* | | |
| -Retrocessionaire's share of claims reported but not yet settled | **-** | 258 |
| -Retrocessionaire's share of policyholders liability | **174** | 1 085 |
| | **174** | 1 343 |
| **Total technical assets** | **338 672** | 220 894 |
| **Net technical liabilities** | | |
| *Non-life insurance contracts* | | |
| -Claims reported but not yet settled | **40 420** | 18 539 |
| -Claims incurred but not reported | **25 651** | 19 304 |
| -Unearned premium provision | **35 052** | 27 949 |
| -Deferred acquisition costs | **(5 656)** | (2 132) |
| | **95 467** | 63 660 |
| *Life insurance contracts* | | |
| -Claims reported but not yet settled | **-** | 86 |
| -Policyholders liability | **59** | 361 |
| | **59** | 447 |
| **Total - net technical liabilities** | **95 526** | 64 107 |

**9. Technical assets and liabilities under insurance contracts** *(continued)*

**9.1 Movements in technical assets and liabilities under insurance contracts** *(continued)*

**Outstanding claims**
*Year ended 31 December 2005*

| | Gross | Reinsurance | Net |
|---|---|---|---|
| Claims reported but not yet settled | **74 501** | **55 876** | **18 625** |
| Claims incurred but not reported | **77 215** | **57 911** | **19 304** |
| Total outstanding at beginning of year | **151 716** | **113 787** | **37 929** |
| Increase/(decrease) in liabilities | **112 571** | **84 429** | **28 142** |
| -arising from current year claims | **141 045** | **105 784** | **35 261** |
| -arising from prior period claims | **(28 474)** | **(21 355)** | **(7 119)** |
| Total at end of year | **264 287** | **198 216** | **66 071** |
| Notified claims | **161 683** | **121 263** | **40 420** |
| Incurred but not reported | **102 604** | **76 953** | **25 651** |
| Total at end of year | **264 287** | **198 216** | **66 071** |

*Period ended 31 December 2004*

| | Gross | Reinsurance | Net |
|---|---|---|---|
| Total at date of incorporation | - | - | - |
| Increase in liabilities | | | |
| -arising from current period claims | 151 716 | 113 787 | 37 929 |
| Total at end of period | 151 716 | 113 787 | 37 929 |
| Notified claims | 74 501 | 55 876 | 18 625 |
| Incurred but not reported | 77 215 | 57 911 | 19 304 |
| Total at end of period | 151 716 | 113 787 | 37 929 |

The expected timing of payment of outstanding claims involves considerable uncertainties. Outstanding claim payment patterns have not yet been established due to the limited number of years that the company has been in operation but most of the outstanding claims are expected to be paid within one year.

**9. Technical assets and liabilities under insurance contracts** *(continued)*

**9.1 Movements in technical assets and liabilities under insurance contracts** *(continued)*

**Unearned premium provision**

*Year ended 31 December 2005*

| | **Gross** | **Reinsurance** | **Net** |
|---|---|---|---|
| At the beginning of year | **111 795** | **83 846** | **27 949** |
| Premiums written during the year not earned | **140 208** | **105 156** | **35 052** |
| Premiums earned during the year | **(111 795)** | **(83 846)** | **(27 949)** |
| Total at end of year | **140 208** | **105 156** | **35 052** |

*Period ended 31 December 2004*

| | Gross | Reinsurance | Net |
|---|---|---|---|
| Total at date of incorporation | - | - | - |
| Premiums written during the year not earned | 111 795 | 83 846 | 27 949 |
| Total at end of period | 111 795 | 83 846 | 27 949 |

The unearned premium provision is earned within a twelve month period from the date it was provided for.

**Deferred acquisition costs**

*Year ended 31 December 2005*

| | **Gross** | **Reinsurance** | **Net** |
|---|---|---|---|
| At the beginning of year | **22 176** | **20 044** | **2 132** |
| Acquisition costs deferred during the year | **35 126** | **29 470** | **5 656** |
| Transferred to costs incurred during the year | **(22 176)** | **(20 044)** | **(2 132)** |
| Total at the end of year | **35 126** | **29 470** | **5 656** |

*Period ended 31 December 2004*

| | Gross | Reinsurance | Net |
|---|---|---|---|
| At date of incorporation | - | - | - |
| Acquisition costs deferred during the period | 22 176 | 20 044 | 2 132 |
| Total at end of period | 22 176 | 20 044 | 2 132 |

### 9. Technical assets and liabilities under insurance contracts *(continued)*

### 9.1 Movements in technical assets and liabilities under insurance contracts *(continued)*

**Life policy holder liabilities**

*Year ended 31 December 2005*

| | **Gross** | **Reinsurance** | **Net** |
|---|---|---|---|
| At beginning of year | **1 446** | **1 085** | **361** |
| Liabilities utilised during the year | **(1 213)** | **(911)** | **(302)** |
| Total at end of year | **233** | **174** | **59** |

*Period ended 31 December 2004*

| | Gross | Reinsurance | Net |
|---|---|---|---|
| At date of incorporation | - | - | - |
| Liabilities created during the period | 1 446 | 1 085 | 361 |
| Total at end of period | 1 446 | 1 085 | 361 |

### 9.2 Short-term insurance contracts – assumptions, change in assumptions and sensitivity

The principal assumptions and estimation methods applied that will affect future cash flows on insurance contracts are as follows:

**Estimates and outstanding claims**

The bases applied in the determination of accrued pipeline premiums, claims, acquisition costs and outstanding claims are the historical data and past experience. These estimation bases and assumptions are adjusted with information and data available from cedants at the time of reporting. Due to the retrocession arrangement with the holding company it is anticipated that changes in the underlying assumptions will not have a significant impact on the net result on a year to year basis. Estimates are particularly sensitive towards quantum of unreported losses.

**Unearned premium provision**

All business underwritten is short-tail in nature. Premiums are earned within a 12 month period, and no non-constant risks are currently underwritten. As a result the earning pattern of the written premiums can be accurately determined and the assumptions underlying the calculation are limited. The same assumptions underpin the calculation of the deferred acquisition cost.

The above assumptions and estimation bases are believed to be reasonable under the circumstances and as a result actual results may differ from those estimates. There has been no change in the principle assumptions and estimation bases from those applied in the previous reporting period.

## Notes to the Financial Statements

*for the year ended 31 December 2005 (continued)*

| | **2005 R'000** | 2004 R'000 |
|---|---|---|
| **10. Amounts due from companies on reinsurance accounts** | | |
| *Non-life* | | |
| Amounts due from ceding companies | **66 293** | 56 244 |
| Amounts due from retrocessionaire | **-** | 50 304 |
| | **66 293** | 106 548 |
| *Life* | | |
| Amounts due from ceding companies | **-** | 587 |
| Amounts due from retrocessionaire | **-** | 3 937 |
| | - | 4 524 |
| **Total** | **66 293** | 111 072 |
| **11. Deposits retained by ceding companies** | | |
| *Non-life* | | |
| At beginning of year | **30 138** | - |
| New deposits retained | **3 601** | 30 138 |
| Deposits released | **(30 138)** | - |
| At the end of year | **3 601** | 30 138 |
| **12. Accounts receivable** | | |
| Dividends receivable | **53** | - |
| Interest receivable | **6 617** | 990 |
| Other prepayments and sundry debtors | **158** | 2 |
| | **6 828** | 992 |
| **13. Cash and cash equivalents** | | |
| Cash on hand | **5** | 3 |
| Current bank account balances | **19 321** | 25 118 |
| Short-term bank deposits | - | 343 |
| | **19 326** | 25 555 |

| | | 2005 R'000 | 2004 R'000 |
|---|---|---|---|
| **14** | **Amounts due to companies on reinsurance accounts** | | |
| | *Non-life* | | |
| | Amount due to retrocessionaire | **100 832** | - |
| | *Life* | | |
| | Amount due to ceding companies | **815** | - |
| | Amount due to retrocessionaire | **2 496** | - |
| | | **3 311** | - |
| | Total | **104 143** | - |
| **15.** | **Deposits due to retrocessionaire** | | |
| | At beginning of year | **231 255** | - |
| | New deposits retained | **293 052** | 231 255 |
| | Deposits released | **(231 255)** | - |
| | At the end of the year | **293 052** | 231 255 |
| | Deposits due to retrocessionaire are allocated as follows: | | |
| | - non-life insurance contracts | **287 070** | 225 930 |
| | - life insurance contracts | **5 982** | 5 325 |
| | | **293 052** | 231 255 |
| **16.** | **Other provisions and accruals** | | |
| | *Creditors and accruals* | | |
| | VAT payable | **2 427** | 2 862 |
| | Other creditors and accruals | **689** | 5 775 |
| | | **3 116** | 8 637 |
| | *Provisions* | | |
| | Provision for accrued leave | **122** | - |
| | **Total other provisions and accruals** | **3 238** | 8 637 |

Accrued leave provision is calculated based on the number of days leave due to employees multiplied by their cost to company. The maturity profile of the provision is dependent on the utilisation of leave days by the employees.

## 17. Deferred tax liability

| | 2005 R'000 | 2004 R'000 |
|---|---|---|
| Opening balance | **427** | - |
| Prior year adjustment | **401** | |
| Current year | **3 826** | 427 |
| Closing balance | **4 654** | 427 |

The net deferred tax liability balance at the end of the period comprises:

| | 2005 R'000 | 2004 R'000 |
|---|---|---|
| – capital allowance | **(49)** | (4) |
| – unrealised gains on revaluation of investments | **4 703** | 431 |
| | **4 654** | 427 |

## 18. Current income tax liability

The current tax liability of R7.6 million (2004: R1.5 million) represents the amount of income taxes payable in the current year less adjustments in respect of prior years.

## 19. Share capital and share premium

| | 2005 R'000 | 2004 R'000 |
|---|---|---|
| Share capital | **–** | – |
| Share premium | **80 300** | 80 300 |
| | **80 300** | 80 300 |
| *Authorised* | | |
| 7 ordinary shares of R0,01 each | **–** | – |
| *Issued* | | |
| 7 ordinary shares of R0,01 each | **–** | – |

Share capital is comprised of seven ordinary shares of R0.01 each of which one share was issued at a premium of R80.3 million.

## 20. Contingency reserve

| | 2005 R'000 | 2004 R'000 |
|---|---|---|
| Opening balance | **13 808** | - |
| Transfer from income | **3 202** | 13 808 |
| Closing balance | **17 010** | 13 808 |

| 21. Revenue account for non-life insurance contracts | 2005 R'000 | 2004 R'000 |
|---|---|---|
| **Income** | | |
| Gross written premiums | **709 354** | 570 963 |
| Retroceded premiums | **(539 254)** | (432 881) |
| Net written premiums | **170 100** | 138 082 |
| Provision for unearned premiums | **(7 103)** | (27 949) |
| Gross amounts | **(28 413)** | (111 795) |
| Retrocessionaire's share | **21 310** | 83 846 |
| Earned premium net of retrocession | **162 997** | 110 133 |
| **Outgo** | | |
| Gross claims paid | **(332 301)** | (215 084) |
| Retroceded claims received | **249 226** | 161 264 |
| Net claims paid | **(83 075)** | (53 820) |
| Provision for outstanding claims | **(28 228)** | (37 843) |
| Gross amounts | **(112 915)** | (151 372) |
| Retrocessionaire's share | **84 687** | 113 529 |
| Claims incurred net of retrocession | **(111 303)** | (91 663) |
| Net commission incurred | **(26 054)** | (10 215) |
| Management expenses | **(16 121)** | (9 886) |
| **Underwriting profit / (loss)** | **9 519** | (1 631) |

| | | 2005 R'000 | 2004 R'000 |
|---|---|---|---|
| **22.** | **Revenue account for life insurance contracts** | | |
| | **Income** | | |
| | Gross written premiums | **15 651** | 16 977 |
| | Retroceded premiums | **(11 892)** | (12 905) |
| | Net written premiums | **3 759** | 4 072 |
| | **Outgo** | | |
| | Gross claims paid | **(12 773)** | (10 172) |
| | Retroceded claims received | **9 580** | 7 629 |
| | Net claims paid | **(3 193)** | (2 543) |
| | Provision for outstanding claims | **86** | (86) |
| | Gross amounts | **344** | (344) |
| | Retrocessionaire's share | **(258)** | 258 |
| | Claims incurred net of retrocession | **(3 107)** | (2 629) |
| | Net commission incurred | **(497)** | (505) |
| | Management expenses | **(552)** | (498) |
| | Transfer from / (to) policyholders liability | **302** | (361) |
| | Gross amounts | **1 213** | (1 446) |
| | Retrocessionaire's share | **(911)** | 1 085 |
| | **Underwriting (loss) / profit** | **(95)** | 79 |

## 23. Commission paid and received

| | 2005 R'000 | 2004 R'000 |
|---|---|---|
| *Non Life* | | |
| Gross commission and brokerage paid | **191 123** | 119 461 |
| Gross deferred acquisition costs | **(12 950)** | (22 176) |
| Commission expense | **178 173** | 97 285 |
| | | |
| Commission revenue | **(152 119)** | (87 070) |
| Retrocession commission and brokerage received | **(143 342)** | (89 644) |
| Overriding commission received | **(18 203)** | ( 17 470) |
| Retroceded deferred acquisition revenue | **9 712** | 16 632 |
| Deferred overriding commission revenue | **(286)** | 3 412 |
| | | |
| Net commission incurred | **26 054** | 10 215 |
| | | |
| *Life* | | |
| Gross commission and brokerage paid | **4 318** | 4 566 |
| | | |
| Commission received | **(3 821)** | (4 061) |
| Retrocession commission and brokerage received | **(3 239)** | (3 424) |
| Overriding commission received | **(582)** | (637) |
| | | |
| Net commission incurred | **497** | 505 |
| | | |
| **Total commission and brokerage expense** | **182 491** | 101 851 |
| **Total commission and brokerage revenue** | **155 940** | 91 131 |

## 24. Net investment income

| | 2005 R'000 | 2004 R'000 |
|---|---|---|
| Interest received | **26 951** | 10 134 |
| Investment management fees | **(525)** | - |
| | **26 426** | 10 134 |
| Dividend income received | **1 783** | 146 |
| Unrealised gains on revaluation of investments | **13 349** | 2 871 |
| Realised profit on disposal of investments | **2 266** | 40 |
| Interest paid | **(12 912)** | (2 437) |
| | **30 912** | 10 754 |
| | | |
| Net investment income is allocated as follows: | | |
| – non-life insurance contracts | **30 271** | 9 971 |
| – life insurance contracts | **641** | 783 |
| | **30 912** | 10 754 |

### 25. Profit before taxation

Profit before taxation is arrived at after charging the following items:

| | 2005 R'000 | 2004 R'000 |
|---|---|---|
| Actuarial fees | **114** | 90 |
| Auditors remuneration: | | |
| – for audit services | **486** | 464 |
| Consultancy fees | **411** | 193 |
| Depreciation | **266** | 145 |
| Amortisation | **23** | 15 |
| Directors remuneration | **1 214** | 952 |
| Executive – for services rendered | **960** | 718 |
| Non executive – for services as directors | **254** | 234 |
| Legal fees | **5** | 83 |
| Leases | **297** | 270 |
| Secretarial fees | **28** | 51 |
| Staff costs including contribution to pension fund, medical scheme and allowance | **2 503** | 1 660 |
| Number of staff | **12** | 10 |

### 26. Taxation

| | 2005 R'000 | 2004 R'000 |
|---|---|---|
| South African normal taxation | | |
| - Current tax – current year | **7 359** | 1 853 |
| - Prior year overprovision of current tax | **(149)** | - |
| - Deferred tax – current year | **3 826** | 427 |
| - Prior year underprovision of deferred tax | **401** | - |
| | **11 437** | 2 280 |

| **Tax rate reconciliation** | % | % |
|---|---|---|
| Effective tax rate | **28,3** | 24,8 |
| Under provision in prior year | **(0,6)** | 0 |
| Exempt income | **1,3** | 0,5 |
| Capital gains | **-** | 4,7 |
| South African standard corporate tax rate | **29,0** | 30,0 |

### 27. Related party transactions

**Holding company**
The company conducts reinsurance business with its holding company. The holding company also charges management fees for services provided by the group and license fees to cover the cost of insurance and accounting software used by the company. Transactions carried out with the holding company are on commercial terms and conditions no less favourable as to the public.

**Key management**
The managing director is considered the only member of key management. Details of his remuneration is disclosed under note 25.

Details of the balances and transactions with the holding company included in the annual financial statements are as follows:

| **Balance sheet** | 2005 R'000 | 2004 R'000 |
|---|---|---|
| **Assets** | | |
| Technical assets under insurance contracts | **303 546** | **198 718** |
| Amounts due from companies on reinsurance accounts | **-** | **50 304** |
| Amount due from holding company | **-** | **798** |
| | **303 546** | **249 820** |
| **Liabilities** | | |
| Deferred retrocession commission revenue | **(29 470)** | **(20 044)** |
| Deposits due to retrocessionaire | **(293 052)** | **(231 255)** |
| Amounts due to companies on reinsurance accounts | **(104 143)** | **-** |
| Amount due to holding company | **(14 749)** | **-** |
| Net liabilities | **(137 868)** | **(1 479)** |

| | **2005** | 2004 |
|---|---|---|
| **27. Related party transactions** *(continued)* | **R'000** | R'000 |
| **Revenue account for non-life insurance contracts** | | |
| Retroceded premiums | **(539 254)** | (432 881) |
| Retrocessionaire's share of provision for unearned premiums | **21 310** | 83 846 |
| Retroceded claims received | **249 226** | 161 264 |
| Retrocessionaire's share of provision for outstanding claims | **84 687** | 113 529 |
| Retrocessionaire's share of net commission incurred | **152 119** | 87 070 |
| Management expenses | **(9 397)** | (4 980) |
| **Revenue account for life insurance contracts** | | |
| Retroceded premiums | **(11 892)** | (12 905) |
| Retroceded claims recovered | **9 580** | 7 629 |
| Retrocessionaire's share of outstanding claims | **(258)** | 258 |
| Retrocessionaire's share of net commission incurred | **3 821** | 4 061 |
| Retrocessionaire's share of policy holders liability | **(911)** | 1 085 |

Related party transactions were made on terms equivalent to those that prevail in arm's length transactions.

**28. Retirement benefits costs**

The company contributes to a defined contribution pension plan for all its employees. The company's contributions to the defined contribution pension plan for its employees during the period were R164 298 (2004: R102 812).

**29. Operating lease commitments**

The company leases photocopiers, fax equipment and office premises. The minimum non-cancellable operating lease payments are payable as follows:

| | **2005** | 2004 |
|---|---|---|
| | **R'000** | R'000 |
| – less than one year | **351** | 151 |
| – between one and five years | **768** | 203 |
| | **1 119** | 354 |

**30. Fair value**

The fair value of all financial instruments is substantially the same as the carrying values reflected in the balance sheet.

### 31. Discontinuing operation

During the year the directors of the company accepted and approved a formal plan for the discontinuance of the company's life insurance business operations to concentrate on non-life business.

A summary of the financial results of the discontinuing operation is as follows:

| | **2005 R'000** | 2004 R'000 |
|---|---|---|
| Underwriting (loss) / profit | **(95)** | 79 |
| Investment income | **641** | 783 |
| Net income before taxation | **546** | 862 |
| Taxation | **(42)** | (260) |
| Net income after tax | **504** | 602 |

### 32. Notes to the cash flow statement

32.1 Reconciliation of cash generated by operations

| | **2005 R'000** | 2004 R'000 |
|---|---|---|
| Net income before taxation | **40 336** | 9 202 |
| Adjusted for : | | |
| - depreciation and amortisation | **289** | 160 |
| - investment income | **(30 912)** | (10 754) |
| - net unearned premium reserve net of deferred acquisition costs | **3 579** | 25 817 |
| Cash generated by changes in working capital | **269 408** | 135 182 |
| Amounts due from companies on reinsurance accounts | **148 922** | (111 072) |
| Deposits retained by ceding companies | **26 537** | (30 138) |
| Debtors and other receivables | **(5 836)** | (992) |
| Amount due from holding company | **15 547** | (798) |
| Creditors and accrued expenses | **(5 399)** | 8 637 |
| Deposits due to retrocessionaire | **61 797** | 231 255 |
| Net outstanding claims reserve | **28 142** | 37 929 |
| Net life policyholders' liability | **(302)** | 361 |
| | **282 700** | 159 607 |

32.2 Reconciliation of taxation paid

| | **2005 R'000** | 2004 R'000 |
|---|---|---|
| Balance payable at the beginning of the period | **(1 547)** | - |
| Current tax charged in the income statement | **(7 210)** | (1 853) |
| Balance payable at the end of the period | **7 649** | 1 547 |
| Taxation paid | **(1 108)** | (306) |

# NOTES

## NOTES