Financial Services
Captive Accounting & Auditing Update - IFRS
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IFRS 7 Financial Instruments: Disclosures

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IFRS 7, "*Financial Instruments: Disclosures*" is the latest development which has potentially significant ramifications for captive insurance companies reporting under International Financial Reporting Standards (IFRS).

IFRS 7 consolidates and expands on existing IFRS financial instrument and related risk disclosure requirements and adds some significant and challenging new disclosures. As a consequence, IFRS 4 "*Insurance Contracts*" and its implementation guidance have been revised to bring insurance contract disclosures in line with IFRS 7. The new standard also amends IAS 1, "*Presentation of Financial Statements*", to require entities to disclose objectives, policies and processes used for managing capital.

In this update, we examine the key changes to IFRS risk reporting, under which insurers will be required to set out how management itself perceives, measures and manages risk.

Effective date

- The new standard is applicable for annual periods beginning on or after January 1, 2007, with prior year comparatives required.
- It applies to all entities that have financial instruments.

Purpose

- IFRS 7 requires financial statement disclosure of certain management information to allow shareholders to view financial instruments and risk management activities 'through the eyes of management'.
- The new standard replaces and updates the disclosure requirements of IAS 32, "*Financial Instruments: Presentation*" and supersedes IAS 30, "*Disclosures in Financial Statements of Banks and Similar Financial Institutions*".

Key financial instrument and related risk disclosure requirements

Qualitative risk disclosures

- For each type of risk (credit risk, liquidity risk and market risk) a qualitative narrative is required, identifying risk exposures and how they arise; and identifying objectives, policies and processes for managing these risks and the methods used to measure risks.

Quantitative risk disclosures

- For each type of risk, entities must disclose summary quantitative data on risk exposure at each reporting date, based on information provided internally to key management personnel and must also disclose any significant concentrations of risk. Entities must also disclose the following information:
- Credit risk –
  - Maximum exposure to credit risk and any collateral held;
  - Information on credit quality of financial assets that are neither past due nor impaired;
  - Analysis of the age of financial assets that are past due but not impaired; and
  - Analysis of financial assets that are individually determined to be impaired.
- Liquidity risk – Maturity analysis for financial liabilities.

- Market risk – Provide sensitivity analysis for each type of market risk (currency, interest rate and other price risk) and disclose the potential impact on the profit or loss and equity of "reasonably possible" changes in relevant risk variables for financial instruments.

Other disclosure requirements

- The above is not an exhaustive list of the comprehensive disclosures required by IFRS 7. The standard's disclosure requirements also extend to:
    - categories of financial assets and financial liabilities;
    - financial assets or financial liabilities at fair value through profit or loss;
    - reclassification;
    - derecognition;
    - collateral;
    - allowance for credit losses;
    - compound financial instruments;
    - defaults and breaches;
    - items of income, expenses, gains or losses;
    - accounting policies;
    - fair value; and
    - hedge accounting.

Key amendments to IFRS 4

- The new standard resulted in amendments to IFRS 4 and accordingly insurers are required to provide quantitative disclosure about credit risk, liquidity risk and market risk that IFRS 7 would require if insurance contracts were within its scope:
    - Credit risk – Examples of credit risk disclosures: Risk that an insurer incurs a financial loss because a reinsurer defaults on its obligations under the reinsurance contract; Disputes with a reinsurer could lead to an impairment of the cedant's reinsurance assets; Financial guarantee contract.
    - Liquidity risk – Analysis, by estimated timing, of the insurance liabilities recognized in the balance sheet.
    - Market risk – Provide sensitivity analysis of insurance liabilities based on reasonably possible changes in relevant risk variables.

Key amendments to IAS 1

- The new standard has resulted in amendments to IAS 1 to require entities to disclose:
    - Quantitative and qualitative information about objectives, policies and processes for managing capital; and
    - A statement of compliance with external regulatory capital requirements.

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