A review of disclosure in the annual financial reports of life insurance companies in South Africa

Darron West
April 1999
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Declaration

I hereby declare that the work on which this dissertation is based is my original work (except where acknowledgements indicate otherwise) and that neither the whole work nor any part of it has been, is being or is to be submitted for another degree in this or any other university.

Darron Garth West
12 April 1999
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Abstract

Overview
The globalisation of the South African economy and the recent corporate activity involving South African life insurance companies has renewed interest in financial reporting by these companies.

There has been little development in guidance on reporting for long term insurers in South Africa since 1994 when AC121 "Disclosure in the Financial Statements of Long-Term Insurers" was published. South African life insurance companies have also fared poorly in recent Excellence in Financial Reporting surveys.

Revisions to the reporting requirements of life insurance companies in the United Kingdom and Australia provide scope for the examination of the usefulness of the financial statements of life insurance companies in South Africa, by investigating the extent and adequacy of disclosure (as proxies for usefulness) by such companies in terms of local and international benchmarks.

Methodology
The research problem was examined by compiling checklists of the disclosure attributes required by the South African, United Kingdom and Australian insurance reporting standards, and scoring the disclosure given by a sample of eleven South African life insurance companies over the period 1993 to 1997.

These scores were subjected to statistical testing (Analysis of Variance) to identify significant differences. Consideration was given to the instances of non-compliance with the respective benchmarks, as well as trends in the presentation of disclosure attributes, and the influence of the international benchmarks on reporting by South African life insurance companies.
Conclusions
The results of this study show that:

- compliance with the disclosure requirements of the local insurance reporting standard is satisfactory
- compliance with the disclosure requirements of the two international benchmarks is inadequate
- there was a significant change in the extent of disclosure by the sample of South African life insurance companies between 1993 and 1995
- there was no significant change in the extent of disclosure from 1995 to 1997
- the international insurance reporting standards have not influenced disclosure by South African life insurance companies.
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<tr>
<td>IOSCO</td>
<td>International Organisation of Securities Commissions</td>
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<td>IASC</td>
<td>International Accounting Standards Committee</td>
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<td>ABI</td>
<td>Association of British Insurers</td>
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<td>SORP</td>
<td>Statement of Recommended Practice</td>
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<td>SA</td>
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<td>UK</td>
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<td>ANOVA</td>
<td>Analysis of Variance</td>
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<td>GAAP</td>
<td>Generally Accepted Accounting Practice</td>
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<td>FSV</td>
<td>Financial Soundness Valuation</td>
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<td>PGN</td>
<td>Professional Guidance Note</td>
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<td>AASB</td>
<td>Australian Accounting Standards Board</td>
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<td>ASSA</td>
<td>Actuarial Society of South Africa</td>
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<td>Commercial Union</td>
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<td>Old Mutual</td>
<td>The South African Mutual Life Assurance Society</td>
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<td>Sanlam</td>
<td>The South African National Life Assurance Company</td>
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<td>Norwich</td>
<td>Norwich Life S.A. Limited</td>
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<td>Southern</td>
<td>The Southern life Association Limited</td>
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<td>African Life Assurance Company Limited</td>
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<td>Fedsure</td>
<td>Fedsure Life Assurance Company Limited</td>
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<td>Sage</td>
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<td>Momentum</td>
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<td>Liberty</td>
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<td>Metropolitan</td>
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<td>Gensec</td>
<td>Genbel Securities Limited</td>
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<td>Santam</td>
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<td>FirstRand</td>
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<tr>
<td>Nedcor</td>
<td>Nedcor Limited</td>
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<tr>
<td>JSE</td>
<td>Johannesburg Stock Exchange</td>
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Chapter 1

Introduction

Financial reporting by life insurance companies is a topical issue. This section sets out the information necessary to appreciate the research problem and the other parameters of the study.

Topical issue

Insurance companies have a major role in any modern economy. Recently, they have been the subject of vast corporate activity in South Africa: Sanlam has demutualised and listed on the JSE, and the Old Mutual is set to follow suit; Southern Life and Momentum have merged under an RMB-Anglo American umbrella company known as FirstRand; Fedsure has acquired a controlling holding in Norwich; Metropolitan Life has bought the entire life operations of and a 22% holding in Commercial Union; and a phenomenon known as "bancassurance" (the merging of institutions with banking and insurance interests to form a combined financial services entity) is becoming more prevalent.

International standards

Although the International Accounting Standards Committee (IASC) has no statement on insurance accounting yet, an insurance accounting project was added to their agenda in April 1997. The initial steering committee meeting was in December 1997, and an issues paper is due for release in 1999. The steering committee has representation from Australia, the UK, the USA, Germany, France, the International Council of Investment Associations, The Netherlands and Japan. IOSCO, the European Commission, the International Association of Insurance Supervisors, the International Actuarial Association and the US Financial Accounting Standards Board all have observer status only on the steering committee.

Throughout this dissertation, the phrases "international standards" and "international benchmarks" are used interchangeably, and refer to the United Kingdom and Australian insurance accounting pronouncements, since these were the benchmarks used for the purposes of comparison to the South African insurance reporting standard.
Previous reporting

Previously, "in an attempt to strengthen public confidence in banks and insurers, past accounting practice has permitted institutions to disclose less information than other enterprises. The view taken was that the long-term stability of these institutions was of paramount importance, and that the reporting of fluctuating profits on a year to year basis could undermine public confidence in this stability. Thus it was the practice for profits to be arrived at after undisclosed transfers to inner (or 'secret') reserves which could be released in bad years, thereby smoothing income and creating the impression of stability. Part V of Schedule 4 to the Companies Act exempted banks and long-term insurers from numerous disclosures required for companies - particularly with respect to the income statement - and sanctioned the creation of secret reserves \[within the life fund\], provided that the income statement disclosed that profits had been arrived at after such transfers had been made.

"Part V of Schedule 4 has been repealed for financial years commencing on or after 1 January 1994, and thus the creation of secret reserves is no longer permitted." (Everingham and Watson, 1998 - italics added).

An accounting guideline, AC204, was issued by the South African Institute of Chartered Accountants (SAICA) in October 1986 to improve the consistency of disclosure amongst long-term insurers. However, it was superseded by an accounting standard, AC121 (issued in February 1994 for financial periods commencing on or after 1 January 1994). It should be noted that "[g]uidelines represent recommendations, and do not establish standards" (Everingham and Watson, 1998). A standard, on the other hand, enunciates promulgated generally accepted accounting practice. Davis (1995) noted that AC121 was necessary as the disclosure requirements prevailing prior to the issuance of AC121 were unsatisfactory, given the exemptions afforded to life insurance companies by Schedule 4 to the Companies Act. As a result, the earnings of life companies were not indicative of financial performance since disclosed earnings included a portion of the undisclosed reserves that were released. Both AC204 and AC121 are discussed in more detail in Chapter 2.

Standard of reporting

Disclosure in the financial statements of long-term insurance companies has been less than satisfactory. In the 1998 Finance Week Excellence in Financial Reporting survey, four of the five long-term insurers evaluated were rated as "poor", and one was rated as "adequate" in the standard of their
reporting. It should be noted that the *Excellence in Financial Reporting* survey evaluated pervasive disclosure requirements, rather than the insurance-specific disclosures examined in this dissertation.

"For long-term insurers, the life fund is central to profitability. The panel felt that the careful explanation that this requires wasn’t forthcoming and that insurers hadn’t moved as swiftly as the banks in improving disclosure once the Schedule 4 exemptions were abolished a few years ago." (Finance Week, *Excellence in Financial Reporting*, February 12-18 1998).

**Review of literature**

Barring the professional standards currently in circulation, literature specifically on the subject of disclosure by life companies is limited. However, the following relevant points were noted:

The need for decomposition of the earnings number of life companies was already identified by Foster (1975), who determined that earnings should be split between the underwriting result, investment returns and capital gains. He further showed how the argument against the inclusion of capital gains and losses in income was not supported.

Meyer et al (1994) noted the following attributes of meaningful disclosure relating to life companies:

- financial information should be clear and relevant, and contain sufficient detail to verify and analyse the results of the company
- profit should be broken down into its most important components, distinguishing between profits from new and existing business, and further distinguishing between profits arising from shareholders’ assets, policyholders’ assets, and transfers between shareholders’ and policyholders’ assets
- a description of the valuation bases and assumptions used, as well as information on how the assumptions were determined
- full details of the effects of changes in the valuation bases and the reasons for such changes
- detail on all items having a significant influence on the timing of the release of profit.
The South African actuarial guideline PGN104 (discussed in more detail in Chapter 5) is effective for years commencing on or after 1 January 1998, and hence compliance with this standard is not examined in this dissertation. The disclosure requirements in PGN104 go some way to providing the disclosure referred to by Meyer et al (1994).

Metropolitan Life was the first listed South African life insurer to make its financial position and prospects easier for stakeholders to understand in their 1997 annual report. Klein (1997), noted that "the move to more transparency saw it provide a full breakdown of its actuarial surplus for the first time ... The new method of disclosure will result in earnings being more volatile than in the past." The actuarial surplus arising during the year was broken down into the following components:

- Operating profit
- Investment income on the excess
- Capital appreciation on the excess

The profit number that was reported was probably still compromised in terms of comparability with other insurers and in consistency of calculation. However, the point is that the first steps were made to render the earnings of a life company more understandable, and the disclosure was of more use in the analysis of current and future earnings than a mere indication of the surplus.

To illustrate that compromise in disclosure by long-term insurers is not a problem specific to South Africa, extracts from the results of a survey conducted by KPMG in Canada in 1997 are included as an appendix. The completeness of compliance with AcG-8 - Actuarial Liabilities of Life Insurance Enterprises - Disclosure (shown under heading 2.1.5 under "Actuarial and Other Liabilities" in Appendix A) should be given particular attention, as those disclosures address the issue of the life fund identified earlier in this chapter. The survey examined reporting by insurance companies quite pervasively - only the aspects relevant to disclosure are included in the appendix. Notwithstanding that fact, the nature and extent of disclosure by Canadian insurers were comprehensively surveyed, and included attributes such as disclosure relating to investments, actuarial liabilities, and reinsurance. The
results of the survey indicate that the requirements of the Canadian insurance standards are onerous even in their own environment, as is shown by the incidence of non-compliance with several disclosure attributes, particularly those relating to risk and its management.

In the United Kingdom, Whewell (1990) points to shortcomings in disclosure by life insurance companies similar to those prevailing in South Africa. Hence, the use of the United Kingdom life insurance reporting standards as a benchmark is justified; they may also serve a purpose in showing the way forward for South African reporting.

**Benchmarks**

Ilsley (1998) identified the following users of the financial statements of long-term insurance companies: clients, intermediaries, regulators, shareholders and potential shareholders, non-executive directors, investment analysts and the media. Policyholders are also users of insurance company financials.

These companies are attracting more attention through the corporate activity and globalisation of the economy referred to earlier. Long-term insurance companies are also of particular interest because of the vagaries of the actuarial valuation and the workings of the life fund. Their previously, and indeed presently limited reporting (as evidenced by their poor showing in the *Excellence in Financial Reporting* (1998) survey) is insufficient to satisfy the needs of sophisticated global users in the various categories described by Ilsley (1998).

Furthermore, as the international harmonisation process gains momentum, it becomes useful to benchmark South African disclosure requirements and the actual disclosure prepared by South African life companies against comparable international standards.

This dissertation will therefore utilise the disclosure requirements for life companies in South Africa, the United Kingdom and Australia to benchmark and evaluate the disclosure given by South African life insurance companies in their annual reports. The UK and Australia have been selected because they have well-developed reporting standards particular to life companies, which have recently been subject to revision. A more detailed comparison of the insurance and actuarial environments in these countries and South Africa...
is included in Appendix I. This comparison provides some evidence of similarity in the three markets, which therefore justifies the benchmarking of South African reporting against those standards.

Meyer et al (1994) gave consideration to profit reporting by life companies in these countries, as well as in the United States and Canada. However, Meyer et al (1994) examined profit reporting only, and approached the subject from a theoretical perspective, dealing principally with the issues arising from the measurement and recognition of profit from the long-term insurance business, and the discretion of the valuator in determining such profits. The nature and extent of actual disclosure by life insurance companies in South Africa was not considered in any detail.

The United States has been excluded from this dissertation on the basis that the accounting profession in that country is not harmonising with international standards (Wixley, *Excellence in Financial Reporting*, 1998), and that their reporting is split between mutuals and proprietary companies, with the accounting standards providing guidance on measurement issues, and the regulatory (legal) framework prescribing disclosure. Furthermore, there have been no recent developments in financial reporting requirements for life companies in the USA.

Although Canada's insurance reporting standards are also well-developed, it has been excluded for the purposes of evaluating the disclosure of South African life insurance companies since much of the disclosure is contingent upon several attributes which are indeterminate from an evaluation of only publicly available information (i.e. insufficient information about the business is presented in the annual report to determine whether or not a specific attribute is relevant to the company or not, and if relevant, whether or not the required disclosure has been given). Although it is conceivable that South African life companies have the capacity to produce the disclosure required by the Canadian standards, a close inspection of the sets of accounts collated for the sample revealed that almost all of the disclosure required by the Canadian standards was not forthcoming for almost all companies in the sample. The assessment of the extent of compliance with the Canadian standards in any more detail would not, therefore, have yielded meaningful or properly interpretable results.
Notwithstanding the exclusion of the Canadian life company disclosure requirements, a disclosure checklist has been included as an appendix, and some consideration is given to the possible effect of the Canadian disclosure requirements on future developments in South African life company reporting in Chapter 5.

The standards mentioned above are considered in more detail in Chapter 2.

**Statement of the problem**

If compliance by companies with disclosure requirements is unsatisfactory, the usefulness of the information included in the annual report of the company is compromised. Since the objective of accounting is to produce useful information for the users of financial statements, it is reasonable to presume that the extent and adequacy of disclosure are suitable proxies for usefulness.

This presumption, as it pertains to the local reporting environment, is based on the fact that a guideline (AC 204) for reporting by life insurance companies existed from 1986 to 1990, and that the guideline formed the basis for the issuance of a standard (AC 121) in 1990. These developments must therefore allow for the reasonable presumption that the information required to be disclosed in the standard would be useful.

Furthermore, for the purposes of this dissertation, the adequacy of local reporting is benchmarked against international best practices, derived from the disclosure requirements of insurance reporting standards in the United Kingdom and Australia. The more demanding disclosure requirements of these respective countries necessarily produce a better indication of what is useful disclosure.

The research problem is therefore:

**What is the extent and adequacy of disclosure (as a proxy for the usefulness of the information disclosed) by South African life insurance companies when compared to local and international life insurance reporting standards?**

Since there was a revision to the disclosure requirements for life insurance companies for years commencing 1 January 1994, the significance of any
difference between the extent of disclosure pre- and post-1994 should be examined. Furthermore, the increased global awareness of South African business after the election in 1994 provides justification for the comparison of local disclosure to international requirements. Consequently, the following sub-problems will be considered:

1. Was there a significant change in the extent of disclosure by life insurance companies in South Africa after the revisions to the disclosure requirements effective from 1994?
2. Was there a trend of increased disclosure from 1995 to 1997? The nature of any non-compliance in this period will also be considered.
3. Have international insurance reporting standards influenced the extent of disclosure by South African life insurance companies? Consideration will be given to:
   - the causality of the association between international requirements and local compliance, and
   - the nature and extent of incremental disclosure by South African life companies.

Objectives

The objective of this study is to evaluate the extent to which South African life insurance companies comply with the disclosure requirements of local and international insurance reporting standards. The extent of compliance with the disclosure requirements of these standards will be used as a proxy for the usefulness of the information included in the annual report.

While it is recognised that these standards themselves might be deficient in the extent of information that they require to be disclosed, it is beyond the scope of this dissertation to assess their adequacy. Notwithstanding this qualification, the extent of compliance with international standards in particular will illustrate the adequacy of disclosure by South African life insurance companies, and indeed the adequacy of the local insurance reporting standard, in a global context. This is becoming increasingly important as local standards are harmonised with IASC requirements (albeit that no IASC standard on insurance exists yet).
Furthermore, it will be useful to assess the significance of the change in the extent of disclosure offered by South African life insurance companies after Part V of Schedule 4 to the Companies Act 1974 was repealed in 1993, and the trend in the extent of disclosure after that date. These factors could illustrate an inclination towards the increased disclosure required by international standards.

Further still, changes in the extent of compliance with international insurance reporting standards could give an indication of the influence of such international standards on local life insurance companies.

Finally, the results of this dissertation could provide a point of departure for the development of an improved reporting standard for life insurance companies in South Africa.

**Value of the research**

This dissertation will illustrate the extent and adequacy of disclosure by South African life insurance companies, with a view to encouraging an increase in the extent of their future disclosure, and a possible revision of the currently prevailing standard in that respect. Furthermore, it could form the preliminary stages of a more advanced research project to develop a new reporting model for life insurance companies in South Africa.
Chapter 2

A comparison of South African and international accounting standards relating to life insurance companies

Accounting issues

In contrast to conventional annual financial statements, the long term nature of the business of a life insurance company poses particular accounting problems. The "life fund" is central to the appreciation of the insurer's accounts, and the requisite focus on disclosure in this regard downplays other disclosure important to ordinary companies (such as property, plant and equipment) as these numbers become less material and less fundamental to the reflection of the economic substance of the business.

Any guidance on accounting for the long term insurance industry should address the following principal areas:

- recognition and measurement
- presentation and disclosure.

It should be noted that the above areas are issues in accounting for long term insurance, and that issues are, by their very nature, unresolved and contentious. The discussion that follows does not pretend to be the definitive commentary on these issues - that is a task for global standard setters - but rather to sketch some background to the disclosure issues that emerge, and hence how the benchmarks used in this study may be contextualised. Presentation and disclosure are dealt with under the heading "Disclosure issues" below.

Recognition and measurement

The recognition and measurement of the actuarial liabilities (the "life fund") and the concomitant emergence of profit are issues as yet unresolved by standard setters. These aspects have historically been the "black box" of life insurance company accounts, where reliance was placed on the actuaries in the derivation of a value for the surplus of assets over liabilities and hence the company's profit.
Meyer et al (1994) addressed the quandary facing the South African insurance industry in respect of the recognition of profit. However, this remains an actuarial question, which is beyond the scope of this study.

In the interim, though, while the comparability and consistency of insurance company accounts remains an unresolved issue, appropriate and thorough disclosure in respect of the actuarial liabilities and shareholder profit entitlements would no doubt alleviate some of the uncertainty in the meaningful interpretation of the annual report of an insurance company.

Business combinations

A subsidiary issue is that of business combinations, which has some relevance in the wake of the corporate restructuring in the life insurance industry that has happened in South Africa recently.

Long term insurance companies are conventionally part of a larger financial services group, or are at the pinnacle of a group structure. The modern convention appears to be for a holding company to be the listed entity, which in turn holds the group's insurance interests. This is certainly true for the recently demutualised and listed Sanlam, and it is apparent that Old Mutual intends to do the same by listing Old Mutual plc as a holding company on the London stock exchange. FirstRand was also formed as a holding company for, amongst others, its insurance interests (Momentum and Southern Life).

Amongst others, issues arise as to how a parent should account for its insurance subsidiary (consolidate it in its entirety, or recognise the net liability, as for retirement benefit liabilities), and how an insurer parent should account for its subsidiaries.

In the interests of consistency with the international harmonisation project, a robust approach to the issue of accounting for an insurance subsidiary would be in terms of IAS27 "Consolidated Financial Statements and Accounting for Investments in Subsidiaries", where the basis premise is that "a parent which issues consolidated financial statements should consolidate all subsidiaries" (IAS27, 1994). It would seem reasonable, therefore, that a parent holding an insurance subsidiary should consolidate the entire subsidiary, including both shareholders' and policyholders' funds as they appear on the insurer's balance sheet.
The issue of fair value accounting comes to the fore in dealing with the consolidation of subsidiaries by insurers, since insurers very often have subsidiaries which are held as strategic investments rather than as operating subsidiaries (cf. Sanlam's holdings in Gensec and Santam, Old Mutual's holding in Nedcor). Questions arise as to whether or not to show such subsidiaries at fair value (i.e. reflect a goodwill figure in the insurer's consolidated accounts based on the annual revision of fair value), and how to treat the excess of fair value over the net asset value of the subsidiary.

Conceptually, these post-acquisition adjustments to fair value are tantamount to internally generated goodwill, the recognition of which is prohibited by IAS38 "Intangible Assets". Consequently, it seems reasonable that to reflect these subsidiaries held as strategic investments at fair value, and to recognise any excess of fair value over net assets on this basis, is unsound practice.

In South Africa, AC121 gives insurers the option of not consolidating subsidiaries, or of equity accounting associates, where the insurer does not exercise its capacity to control or significantly influence the investee. This is allowed on the basis that, in this instance, "consolidation and equity accounting do not provide meaningful information to the users of financial statements" (AC121, 1994). Paragraph .11 of AC121 allows insurers to account for these investments at fair value. Clearly, this is a treatment inconsistent with the deduced international line of thought noted above.

**Disclosure issues**

Presentation and disclosure give effect to the informational content of and usefulness of a set of financial statements. Inasmuch as this is the purpose of disclosure, and as it pertains to life insurance companies, it should specifically address the issues of the actuarial liabilities and the life fund, and profit emergence.

Given the unique and rather complex nature of the life insurance business, one issue that arises upon the consideration of insurance company accounts is whether or not the formats of the income statement, balance sheet and cash flow statement should be prescribed or not. Such prescription would enhance the comparability of insurance company accounts through...
standardisation, but it is conceivable that the absence of professional judgement in their preparation might detract from the reflection of the economic reality of the business. Conversely, one should perhaps also consider the limitations and effects of inadequate professional judgement in the determination of the information which is used to derive the required disclosures, since this would render the information disclosed less useful and meaningful.

Specific considerations relating to disclosure by life insurance companies include:

- the presentation of components of income and expenditure. A proper assessment of the drivers of profit in a long term insurance company is essential to an appreciation of its results.
- investment return. It has already been appreciated that this component of a life insurance company's earnings renders those earnings volatile (c.f. reference to Metropolitan Life in Chapter 1). The issue surrounding the disclosure of investment return is the extent of the breakdown required, and its inclusion in the operating returns. Insurance companies in South Africa have tended to show one line item reflecting "realised and unrealised gains on investments", and have also recently removed this item from "headline earnings" on the basis that it renders the earnings number too volatile. It is obvious that guidance is necessary here.
- policyholder disclosures. The questions here relate to the level of detail of these disclosures, as well as the separation of policyholder amounts from shareholder amounts. It is probably fair to say that policyholders are as much of an interested user group of life insurance company accounts as shareholders and investors are. It is also notable that a portion of the profit attributable to shareholders is derived from life operations and the application of policyholder funds. These observations must offer some credence to the separate disclosure of those parts of financial position and performance attributable to policyholders and shareholders, as well as the disclosure of the profit entitlements of shareholders relating to policyholders' funds.
- actuarial disclosures. This remains the "unknown quantity" in a set of life insurance accounts. Significant narrative and quantitative disclosure is necessary for users to appreciate the amounts of and changes in the
actuarial liabilities and the life fund. However, the extent of such disclosure remains a contentious issue, since the creation of a balance between useful information and information overload is a difficult task.

- financial instruments. The long-term nature of the life insurance business, and the associated importance of stability and risk management make disclosures relating to financial instruments critical. An emerging issue is therefore whether or not the level of detail of the disclosure requirements of local and international accounting standards on financial instrument disclosures are sufficient for the specific purposes of life insurance companies, or if supplementary guidance on this type of disclosure is necessary.

The identification of these issues regarding disclosure by life insurance companies provides some background to a comparison of the South African, United Kingdom and Australian reporting benchmarks used in this study.

**Comparison of benchmarks**

AC121 "Disclosure in the Financial Statements of Long-Term Insurers" is the applicable insurance-specific standard in South Africa. Everingham and Watson note that "AC121 had been preceded by a Guideline, AC204 "Accounting and Reporting Practices of Long Term Insurance Institutions" (issued in 1986), which dealt with both accounting and disclosure practices of long-term insurers; many of its disclosure requirements were incorporated in Statement AC 121, which is therefore not an entirely new document" (Everingham and Watson, 1998, *italics added*).

It is equally important to note that there has been no development of AC121 since its issue in 1994. As such, the standard is becoming dated.

AC121 gives guidance as to some of the more basic disclosure requirements pertinent to a life insurance company (e.g. inclusion of an actuary’s report, segmental analysis of the insurer’s investment portfolio, disclosure of the major components of income). However, it can hardly be said to come to grips with the issues of the actuarial liabilities and profit emergence. All that is required to be disclosed in terms of the life fund are the movements on that fund arising from transfers to and from the income or operating statement, and gains or losses arising on the revaluation and disposal of investments.
With such minimal disclosure, the life fund continues to be the “black box” of life insurance reporting, both in terms of the composition of the actuarial liabilities, and how they impact on the insurer’s profit figure.

A specific anomaly in AC121 is the required disclosure in terms of paragraph .32, where the maturity values, capital portions retained, and death or disability claims pertaining to retirement annuity claims must be shown. It is impossible to assess compliance with such disclosure - the issue is one of classification only, and cannot be determined from a review of the annual report itself. One can only imagine that this paragraph was included in the statement for the preparers and auditors of long-term insurance company accounts.

When compared to the international benchmarks from the United Kingdom and Australia, AC121 is revealed as a wholly inadequate standard for such a complex industry.

Unlike South Africa, the UK insurance reporting requirements are largely entrenched in law. The reporting format and required disclosures are included in Schedule 1 to the 1993 Regulations of the UK Companies Act 1985. These standards of reporting implemented into UK law the European Union Council Directive on the annual accounts of insurance undertakings, and were effective for accounting periods commencing on or after 23 December 1994.

The Association of British Insurers (“ABI”) has also offered guidance on reporting by life insurance companies in the UK, primarily in order to assist insurance companies in implementing the requirements of the 1993 Regulations. For the purposes of this study, the Draft Statement of Recommended Practice (“SORP”) dated January 1998 was used.

The UK disclosure requirements are highly detailed. While a comprehensive analysis of the UK reporting requirements is not warranted here, a brief overview of the reporting formats and principal disclosure requirements will allow the reader to appreciate the analyses conducted in Chapter 4.

The profit and loss accounts are divided between the “technical account”, and the “non-technical account”. The technical account is effectively the result of
life operations, being premium income, plus investment income, plus gains on investments, less claims paid, less changes in the actuarial liabilities, less expenses, less taxation attributable to the long-term business, less transfers to the "fund for future appropriations" (an explanation of this fund will follow). The result is the profit from life operations attributable to shareholders, and is the starting point of the non-technical account.

Clearly then, the non-technical account represents the profit earned by shareholders. It begins with the shareholders' profit arising from life operations, which is the amount carried over from the technical account. This amount is grossed up by the taxation in the technical account attributable to shareholders, and investment income and gains on investments (on the shareholders' funds) are added to it. Expenses and tax attributable to ordinary activities are subtracted, giving the profit attributable to shareholders for the financial year.

The balance sheet is quite simple, being differentiated between assets on the one side, and liabilities and "capital and reserves" on the other. It is worth pointing out that assets held specifically to back linked liabilities are shown separately. This will be exactly equal to the "technical provision for linked liabilities" shown in the liabilities section. Users are thus able to identify separately that component of actuarial liabilities that varies as a function of the market value of the underlying assets. Any additional actuarial provisions set up to cover additional mortality or expense risks for this business will be included within the "long term business provision" (considered below). Furthermore, deferred acquisition costs, being the costs of acquiring insurance policies which are incurred during a financial year but relate to a subsequent financial year, must be shown as a separate asset. This covers the fact that for most products substantial up front commission and administration costs are incurred whereas product margins will come out over the term of the policy. In South Africa, these costs are implicit in the actuarial valuation.

The "long term business provision" comprises the actuarially estimated value of the company's liabilities (excluding technical provisions for linked liabilities) including bonuses already allocated to policyholders. This is effectively the bulk of the "actuarial liabilities" in South African life insurance company
balance sheets. The UK reporting standards also require that the provision for claims outstanding and provisions for other risks and charges, which are implicitly included in the South African actuarial liabilities, should be explicitly and separately shown on the face of the balance sheet.

Certainly, one of the more interesting phenomena on a UK insurance company's balance sheet is the "fund for future appropriations". This amount represents all funds, the allocation of which to either policyholders or shareholders has not been determined by the end of the financial year. For a traditional with-profits company this is likely to be a substantial number. In South Africa, this amount has historically been referred to as the "balance of excess" which has been included in the life fund.

The UK standards clearly differentiate between the results of life operations (policyholders' funds), and the profit attributable to shareholders as a result of the life operations and the investment return on shareholders' funds. Also, the uncertainty associated with the ownership of the "fund for future appropriations" is not hidden in a generic life fund, but shown separately. The UK therefore offers some very explicit guidance which South African companies would do well to emulate in rendering their financial statements more useful.

Australia released ED73 "Financial Reporting of Life Insurance Business" in 1996. While not as detailed in its disclosure requirements as the UK, it still requires disclosure of details that address the economic reality of the life insurance business, which the South African AC121 fails to do.

An important environmental element to consider when comparing Australian reporting requirements with those of South Africa is the fact that Australian life insurance companies must have several life funds, differentiating between:

- Investment linked funds, which include
  - the Australian ordinary fund, and
  - the Australian superannuation fund;
- Non-investment linked funds, which include
  - the Australian ordinary participating/non-participating fund,
  - the Australian superannuations participating/non-participating fund, and
• the New Zealand ordinary participating fund.

This differentiation becomes an issue when disaggregated information (balance sheet and income statement items) relating to each of these funds is required to be shown. This is clearly less relevant in South Africa, where companies utilise just a single life fund.

The format of the "statement of financial performance" is remarkably like that of South African life insurance companies. The explicit differentiation between shareholders and policyholders, and the result of life operations attributable to shareholders, as in the UK, is not evident. A generic "amounts paid or allocated to policyholders" is shown before the "operating profit before tax". However, the derivation of this amount is evident from the abundance of supplementary actuarial disclosure given in the notes to the financial statements.

The balance sheet is also very similar to those produced by South African life insurers, with the actuarial liabilities being shown as a single line item "policy liabilities". The note disclosure associated with this simple line item is extensive, though, and produces information highly pertinent to the appreciation of the actuarial liabilities: actuarial assumptions need to be defined and quantified in detail. There has been some criticism that the extent of this actuarial disclosure is excessive for the needs of users, and represent information overload (Bartlett, 1997). However, it must be said that the disclosure of these assumptions renders the financial accounts of insurance companies somewhat comparable with one another, as well as making the actuary responsible for the valuation of the policy liabilities accountable for the justification of his assumptions used.

As with the "fund for future appropriations" in the UK, Australian life insurance accounts separately disclose "other retained profits", being retained profits not wholly attributable to shareholders, with an explanatory note defining the basis upon which the amounts in "other retained profits" would be distributable to shareholders. This type of disclosure, as has been noted previously, is absent from South African reporting.
Summary

The South African insurance reporting standard, AC121, is clearly deficient in comparison to the UK and Australian benchmarks used. It cannot be said that the respective industries are so dissimilar that any of the disclosures required by the international standards are not applicable to South African life companies.

While the international benchmarks make a concerted effort to address the specific issues relating to life insurance reporting, being the actuarial liabilities (included in the life fund) and profit reporting, the South African standard avoids these aspects.

With this background, the rest of this dissertation examines the detail of the respective reporting requirements and the usefulness, or lack thereof, of reporting by South African life insurance companies.
Chapter 3

Research design

Research questions

The research questions detailed below follow from the research problem and its sub-problems as set out in Chapter 1:

1. Is the extent of disclosure by South African life insurance companies consistent with the requirements of local reporting standards?
2. Is the extent of disclosure by South African life insurance companies inadequate in relation to international reporting standards?
3. Was there a significant increase in the extent of disclosure by South African life insurance companies from 1993 to 1995?
4. Have South African life insurance companies offered significantly more disclosure from 1995 to 1997?
5. Have international insurance reporting standards significantly influenced the extent of disclosure by South African life insurance companies?

Methodology

Approach

The research problem has been investigated by:

1. The compilation of disclosure checklists to score the extent of disclosure by South African life insurance companies, using the respective local and international benchmarks referred to in Chapter 1, over the period from 1993 to 1997.
2. The evaluation the results of these scores statistically and qualitatively to test the hypotheses referred to above. The statistical methodology followed is explained later in this section.

Limitations

The scope of the study is limited as follows:

1. This dissertation will not consider the measurement of assets or liabilities from either an accounting or an actuarial perspective.
2. Only disclosure specific to life insurance companies as enunciated in insurance reporting standards will be evaluated, as opposed to pervasive disclosure requirements applicable to all companies.

Assumptions

The following principal assumptions have been made:

1. The provision of current and additional disclosure is costless.
2. All required disclosure can be provided by all life insurance companies without prejudice.
3. International disclosure requirements are in the public domain and are known to South African life insurance companies.
4. The current local and international disclosure requirements enunciated in standards and exposure drafts are representative of the ideal, and as such may be retrospectively applied as standard benchmarks when evaluating company compliance.

Sample

The sample of annual reports of life insurance companies for financial years ended 1993 to 1997 will include the ten largest companies based on the Life Offices Association ("LOA") Circular 2/98, and African Life Assurance Ltd ("Aflife").

- This sample embodies more than 97% of the total assets and over 95% of the total income of the population of life insurance companies in South Africa (Life Offices Association, January 1998).
- Aflife has been included in the sample as, although it has not been included in the ten largest offices per the LOA statistics, its market capitalisation at the end of 1997 exceeded that of Commercial Union, Norwich and Sage. Given this indicator of size, it seems sensible to include the company in the sample.

Barring the two mutual insurers, Sanlam and Old Mutual, all the other nine companies in the sample are listed. The choice of this sample is justified by virtue of the use of the annual financial statements of listed companies to make investment decisions. This is one of the cornerstones of the conceptual framework (AC000) of accounting in South Africa. Hence, inasmuch as the nature and extent of disclosure is being used as a proxy for usefulness in this dissertation, the evaluation of listed life insurance companies is appropriate.
The two mutual insurers have been selected not only on the basis of their size and dominance of the industry in South Africa, nor only because of their extensive policyholder bases (i.e. the envisaged users of their financial statements), but also because of Sanlam's demutualisation and listing in 1998, and Old Mutual's intention to do the same in 1999. These actions will place these two companies in the same reporting paradigm as the already listed life insurers - hence, the criterion of usefulness applies equally to their annual financial statements.

The full sample of companies examined are listed in Appendix C.

Data capture

The disclosure checklists are included in Appendix D.

The annual financial statements of each of the companies in the sample were obtained for each of the years from 1993 to 1997 (inclusive of those respective years).

These financial statements were then carefully scrutinised for the various disclosure attributes which have been tabulated in the disclosure checklist spreadsheets.

Scoring was conducted as follows:
• 1 point was awarded for compliance with an attribute.
• ½ point was awarded for partial compliance. Partial compliance is noted in cases where either only a component of a disclosure attribute requiring more than one component is disclosed, or where a separate disclosure requirement is incorporated with some other disclosure attribute. The effect of this classification is to indicate where information is shown, but its usefulness is compromised by a lack of complete transparency, which full compliance would otherwise provide.
• 0 was awarded for non-compliance.
• no score was noted if compliance with the attribute was indeterminate or irrelevant. This prevents results from being skewed by indeterminate attributes, since these items do not affect either the numerator or the denominator of the percentage disclosure score.
In order to render comparisons meaningful, the scores for each company within the respective countries’ disclosure checklists were reduced to percentages. These percentages were calculated as the aggregate score divided by the number of applicable attributes. This was done to avoid prejudicing companies for whom certain attributes were not relevant.

The scores for each of the companies across all the years and within the respective sets of disclosure requirements are included in Appendix E.

**Statistical methodology**

*Introduction*

In order to appreciate the results of the analysis in Chapter 4, an explanation of the statistical tests used and the rationale behind the qualitative analysis is included below. Analysis of Variance (including Scheffe’s method of multiple comparisons) was used. The manner in which this technique was applied to the data is also explained.

*Normality of data*

Given the limited sample size, normality of the data could not be assumed; hence, conventional parametric statistical analysis would not necessarily have yielded sound results. Consequently, the non-parametric Spearman’s rank correlation coefficient and Analysis of Variance (ANOVA) were used.

*ANOVA*

ANOVA is a robust parametric test where the conclusions are approximately true for non-normal populations where sample sizes are about equal. These circumstances are applicable to the data used in this dissertation.

ANOVA tests three or more sample means for equality. There are three types of ANOVA:

- One factor ANOVA, which tests whether the population means of a number of samples (treatment variables) are equal, against the alternative hypothesis that at least one mean is different from the rest;
- Two factor ANOVA, which is applicable where a second factor (blocking variables) could account for some of the variability observed within the sample means, and
- Two factor ANOVA with replication (or interaction), which also detects whether certain combinations of treatment and blocking variables give rise to variability within the samples.
"Mathematically, the relationship between the variations in the dependent variable's responses can be expressed as follows:

Total variability = explained variability (due to treatment variables, blocking variables and interaction effects, where appropriate) + unexplained variability" (Wegner, 1996, italics added).

The extension of the ANOVA method to include blocking variables and interaction effects is in order to reduce the unexplained variability, where possible.

For each source of variation (treatment and blocking variables, any effects of interaction and the residual or unexplained variation), a sum of squares is determined. This is divided by the degrees of freedom of the source of variation to arrive at the mean square. The means squares of each of the sources of variation are in turn divided by the mean square for error (the unexplained variation) to arrive at an F-ratio for the treatment variable, and the blocking variable and interaction effect. These measures are represented in the table below:

Table 1: ANOVA formulas

<table>
<thead>
<tr>
<th>Source of variation</th>
<th>Sum of squares</th>
<th>Degrees of freedom</th>
<th>Mean square</th>
<th>F-ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Between treatment levels</td>
<td>( SSTR = \sum_{j=1}^{r} \sum_{i=1}^{b} (Y_{ij} - \bar{Y})^2 )</td>
<td>( (r-1) )</td>
<td>( MSTR = \frac{SSTR}{r-1} )</td>
<td>( \frac{MSTR}{MSE} )</td>
</tr>
<tr>
<td>Between blocking levels</td>
<td>( SSB = \sum_{j=1}^{b} n_i (\bar{Y}_j - \bar{Y})^2 )</td>
<td>( (b-1) )</td>
<td>( MSB = \frac{SSB}{b-1} )</td>
<td>( \frac{MSB}{MSE} )</td>
</tr>
<tr>
<td>Interaction effect</td>
<td>( SS = \sum_{j=1}^{r} \sum_{i=1}^{b} \sum_{k=1}^{n} (Y_{ijk} - \bar{Y}_{ij})^2 )</td>
<td>( (b-1)(r-1) )</td>
<td>( MSI = \frac{SS}{(r-1)(b-1)} )</td>
<td>( \frac{MSI}{MSE} )</td>
</tr>
<tr>
<td>Residual (unexplained)</td>
<td>( SSE = \sum_{j=1}^{r} \sum_{i=1}^{b} \sum_{k=1}^{n} (Y_{ijk} - \bar{Y}_{ij})^2 )</td>
<td>( rb(n-1) )</td>
<td>( MSE = \frac{SSE}{rb(n-1)} )</td>
<td>( \frac{MSE}{MSE} )</td>
</tr>
<tr>
<td>Total</td>
<td>( SST = \sum_{j=1}^{r} \sum_{i=1}^{b} \sum_{k=1}^{n} (Y_{ijk} - \bar{Y})^2 )</td>
<td>( nrb-1 )</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

where:
- \( n \) = the number of repeated measures per combination of treatment and blocking variable levels
- \( r \) = the number of treatment variable levels (samples)
- \( b \) = the number of blocking variable levels
- \( \bar{Y} \) = the overall mean
The F-ratio is the most crucial statistic, since where the calculated ratio exceeds the critical ratio (with degrees of freedom being those of the variable under consideration, and the residual degrees of freedom) at a specified significance level, the null hypothesis of equality of the means is rejected.

Wegner (1996) demonstrates that this method identifies which pairs of means differ significantly from one another. Absolute differences between each pair of means are compared against a calculated critical range. The calculation for the critical range is as follows:

Equation 1: Critical range for Scheffe's method

$$\text{Critical range} = \sqrt{\frac{df * F_{a, df_1, df_E}}{df_1}} * \sigma$$

Where:
- $df$ is the number of degrees of freedom for a variable
- $F$ is the determined F-Statistic (F-critical) for the specified significance ($\alpha$) and the appropriate degrees of freedom of the variable in question ($df_1$) and the residual degrees of freedom ($df_E$)
- $\sigma$ is calculated by the following formula:

Equation 2: Sigma in the critical range

$$\sigma = \sqrt{\frac{1}{n_p} + \frac{1}{n_q}} \cdot MSE$$

where:
- $n_p$ is the sample size of the $j^{th}$ variable
- MSE is the mean square error (the within sample variation)
The absolute values of the sample means are compared to this critical range. Where the difference is less than the critical range, it is not significant. Where a difference is greater than the critical range, the difference is significant and is giving rise to the rejection of the ANOVA null hypothesis.

**Incremental disclosure evaluation**

The annual reports of the respective companies in the sample were examined for instances of increments in the extent of compliance with the three benchmarks used, comparing the changes from 1993 to 1995, and from 1995 to 1997.

To derive these results, the differences between the disclosure attributes for each of the companies in the sample between the respective years were determined from the same test data as was used for the previously mentioned statistical tests. This data was then tabulated.

Since the statistical significance of the differences in the extent of reporting between the benchmarks and between the years under consideration was determined by the ANOVA testing already described, the incremental disclosure evaluation was not subjected to any specific statistical test.

**Application**

**Hypotheses 1 and 2**

(Extent and adequacy of reporting)

These methods set out to test the significance of the difference between the current actual compliance with the respective insurance reporting standards (denoted by the scores collated using the disclosure checklists) and ideal compliance with those standards.

In this case, it seems sensible only to examine the 1997 annual financial statements of the companies in the sample, since this will give an indication of the current (and most relevant) status of the extent of disclosure.

The extent of compliance by the sample of companies with the three respective benchmarks is evaluated discursively with reference to tabulations of areas of non-compliance identified by an examination of the disclosure scores of the sample of companies.
ANOVA is used to test for the significance of differences in the extent of disclosure provided under the respective benchmarks used.

**Hypotheses 3 and 4**

*(Changes in the extent of disclosure)*

The ANOVA method is used to test the significance of the differences in the disclosure scores of the sample of companies between the respective benchmarks and years under consideration.

In the case of the comparison of the extent of compliance with the three benchmarks, where the F-value exceeds the critical F-value, evidence exists of a significant difference between at least one benchmark's mean and the others. Scheffe's method is then used to identify between which pair of benchmarks the difference exists.

Similarly, the significant differences in the extent of compliance between the respective years being examined are identified.

**Hypothesis 5**

*(Influence of international benchmarks)*

The extent of influence of the international benchmarks on the nature is examined by way of a discursive evaluation of the results of the other tests conducted and commentary raised on those results, referring specifically to the instances and extent of the incremental disclosures offered by the sample of companies in terms of the international benchmarks used.

It is important to note the difference between association and causality in regard to this hypothesis. While evidence may exist of an association between the extent of the disclosure given by the sample of companies evaluated and the requirements of the international benchmarks, this does not of itself prove a causal influence of the international benchmarks on local reporting. This factor will be examined in the analysis of the results pertinent to this hypothesis.

**Summary**

The application of the statistical and other methods to the hypotheses is summarised in the table below. The "population" referred to in some of the
hypotheses is the population of life insurance companies in South Africa, from which the sample has been drawn. The population mean is therefore the mean disclosure score determined by the evaluation of the extent of compliance by the sample with each of the reporting benchmarks (SA, UK, Australia) used.

The column "Hypotheses" details the intuitive hypotheses developed in Chapter 1. The column "Statistical hypotheses" gives the appropriate hypotheses for the respective methodologies applicable to each hypothesis. The $H_0$'s and $H_1$'s in the respective columns are not necessarily comparable, since the null hypothesis in the intuitive hypothesis could be proved by the alternate hypothesis of the statistical method followed. This is as a result of the design of the statistical tests. However, this anomaly has no impact on the results of the statistical tests or the interpretation thereof.
<table>
<thead>
<tr>
<th>Hypotheses</th>
<th>Statistical hypotheses (where applicable) and method</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Main problem: Hypothesis 1</strong></td>
<td>Qualitative evaluation of scores and ANOVA testing of the significance of the difference between the actual level of compliance and the ideal.</td>
</tr>
<tr>
<td><em>H₀:</em> The extent of disclosure satisfies the requirements of local standards.</td>
<td><em>H₀:</em> Actual and ideal population means are equal.</td>
</tr>
<tr>
<td><em>H₁:</em> The extent of disclosure does not satisfy the requirements of local standard.</td>
<td><em>H₁:</em> Actual and ideal population means are different.</td>
</tr>
<tr>
<td><strong>Main problem: Hypothesis 2</strong></td>
<td>Qualitative evaluation of scores and ANOVA testing. ANOVA is used to test for the significance of differences in the extent of disclosure between each of the respective benchmarks.</td>
</tr>
<tr>
<td><em>H₀:</em> The extent of disclosure satisfies the requirements of international standards.</td>
<td><em>H₀:</em> All population means for scores across all benchmarks are equal.</td>
</tr>
<tr>
<td><em>H₁:</em> The extent of disclosure does not satisfy the requirements of international standard.</td>
<td><em>H₁:</em> At least one population mean is different.</td>
</tr>
<tr>
<td><strong>Sub-problem 1: Hypothesis 3</strong></td>
<td>ANOVA.</td>
</tr>
<tr>
<td><em>H₀:</em> There was no significant change in the extent of disclosure between 1993 and 1995.</td>
<td><em>H₀:</em> All population means for scores across years are equal.</td>
</tr>
<tr>
<td><em>H₁:</em> There was a significant change in the extent of disclosure between 1993 and 1995.</td>
<td><em>H₁:</em> At least one population mean is different.</td>
</tr>
<tr>
<td><strong>Sub-problem 2: Hypothesis 4</strong></td>
<td>ANOVA.</td>
</tr>
<tr>
<td><em>H₀:</em> Companies have not complied better with benchmarks since 1995.</td>
<td><em>H₀:</em> All population means for scores across years are equal.</td>
</tr>
<tr>
<td><em>H₁:</em> Companies have complied better with benchmarks since 1995.</td>
<td><em>H₁:</em> At least one population mean is different.</td>
</tr>
<tr>
<td><strong>Sub-problem 3: Hypothesis 5</strong></td>
<td>Discursive evaluation.</td>
</tr>
<tr>
<td><em>H₀:</em> International insurance standards have not influenced reporting by South African life companies.</td>
<td></td>
</tr>
<tr>
<td><em>H₁:</em> International insurance standards have influenced reporting by South African life companies.</td>
<td></td>
</tr>
</tbody>
</table>
Chapter 4

Analysis of results

Hypothesis 1

Compliance with local standards

A tabulation of the disclosure scores (described in Chapter 3) is included in Appendix E.

The disclosure scores for all of the companies were subjected to ANOVA testing, with the companies themselves as the treatment variables, and the actual and ideal disclosure scores as the blocking variables. The disclosure results of the ANOVA tests are included in Appendix G. The ANOVA test results in respect of this hypothesis may be summarised as follows:

- The F-value for the variation between the actual scores and the ideal (33,19) far exceeded the critical F-value (4.97), implying that the actual scores differ significantly from the ideal scores.
- Scheffe’s method is not necessary, since only two blocking variables were tested.

This result corroborates the intuitive observation that actual compliance with the local standard is not complete, although this is mitigated by the subjective observation that the minimum level of compliance is 78%. The statistical result, in isolation, reflects a more compromising situation than prevails in reality.

Therefore, a useful exercise is to identify the nature of those aspects of disclosure which have compromised the scores shown in Appendix E. Only the 1997 results of the respective companies were examined for such non-compliance, since these results are clearly the most relevant of all those that were examined.

Table 2 below are the areas of non-compliance with the local standard on insurance accounting, with the average compliance rate (expressed as a percentage) across all companies.

A review of disclosure in the annual financial reports of life insurance companies in South Africa: 1999
### Table 3: Instances of disclosure non-compliance - South Africa: 1997

<table>
<thead>
<tr>
<th>Standard reference</th>
<th>Disclosure required</th>
<th>Rate of compliance</th>
<th>Companies with omissions</th>
</tr>
</thead>
<tbody>
<tr>
<td>AC121.26</td>
<td>Reinsurance premiums [Note 1]</td>
<td>9%</td>
<td>All except Metropolitan</td>
</tr>
<tr>
<td>AC121.27</td>
<td>Reinsurance benefits [Note 1]</td>
<td>9%</td>
<td>All except Metropolitan</td>
</tr>
<tr>
<td>AC121.38</td>
<td>The fact that the insurer manages assets on behalf of third parties, and the fair value of such managed assets</td>
<td>45%</td>
<td>Commercial Union, Fedsure, Metropolitan, Sage, Southern, Aflife</td>
</tr>
<tr>
<td>AC121.15</td>
<td>A segmental analysis of the total equity investment</td>
<td>73%</td>
<td>Commercial Union, Sage, Southern</td>
</tr>
<tr>
<td>AC121.27(f)</td>
<td>Group scheme terminations</td>
<td>82%</td>
<td>Commercial Union and Old Mutual</td>
</tr>
<tr>
<td>AC121.33</td>
<td>Operating/management expenses in total, excluding sales remuneration</td>
<td>82%</td>
<td>Momentum and Sage</td>
</tr>
<tr>
<td>AC121.33</td>
<td>Sales remuneration separately disclosed</td>
<td>82%</td>
<td>Momentum and Sage</td>
</tr>
<tr>
<td>AC121.25</td>
<td>The major components of investment income, such as interest, dividends, net rentals and other income</td>
<td>86%</td>
<td>Partial compliance by Sage</td>
</tr>
<tr>
<td>AC121.26</td>
<td>Premium income (net of reinsurance) from policyholders grouped and disclosed in the following categories:</td>
<td></td>
<td>All except Metropolitan</td>
</tr>
<tr>
<td></td>
<td>a) Individual single premiums</td>
<td>91%</td>
<td>Aflife</td>
</tr>
<tr>
<td></td>
<td>b) Individual recurring premiums</td>
<td>91%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>c) Group lump sum</td>
<td>91%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>d) Group other</td>
<td>91%</td>
<td></td>
</tr>
<tr>
<td>AC121.13(d)</td>
<td>A statement of cash flow information</td>
<td>91%</td>
<td>Commercial Union</td>
</tr>
<tr>
<td>AC121.14</td>
<td>Details of movements in the life fund distinguishing between:</td>
<td>91%</td>
<td>Southern</td>
</tr>
<tr>
<td></td>
<td>a) Transfers to and from the income or operating statement</td>
<td>95%</td>
<td>Partial compliance by Southern</td>
</tr>
<tr>
<td></td>
<td>b) The aggregate gains or losses on revaluation and disposal of investments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>AC121.21</td>
<td>Inclusion of a statement of actuarial values of assets and liabilities in the actuary's report</td>
<td>95%</td>
<td>Partial compliance by Southern</td>
</tr>
</tbody>
</table>

**Note 1**: Refer to Chapter 3 for the treatment of these disclosure requirements in the scoring process.

**Principal omissions**

It is clear from the table above that the principal areas of non-compliance with the local standard in 1997 were:

- disclosure of reinsurance premiums and benefits, and
- disclosure of the fact that the insurer manages assets on behalf of third parties, and the fair value of such managed assets.

**Reinsurance**

The non-disclosure of reinsurance premiums and benefits is fairly simple to explain. AC121 only requires these attributes to be disclosed if material.
Discussion with various authoritative persons in the South African insurance industry indicates that reinsurance in the South African life insurance industry is not that extensive. Reinsurance could be construed as something of an issue at Metropolitan Life, since it has historically underwritten the lower income segment of the market, and hence borne somewhat higher risks than other life insurance companies. Some comfort should be taken from the fact that all of the companies in the sample were audited, and that reinsurance premiums and benefits, if material, would have been disclosed upon the recommendation of the auditors.

Managed assets

A more curious omission by some 55% of the sample was that of the disclosure of the fact that the insurer manages assets on behalf of third parties and the fair value of such assets. The information is clearly important, since it provides insight into the composition of the insurer's income i.e. what proportion of income is derived from asset management operations, and what proportion is derived from pure life and underwriting activities. Conceivably, the companies which omitted this disclosure either have minimal managed assets (which is unlikely, given the rise of this type of business), or are less inclined to provide evidence of the mix of their income, which could potentially compromise the market rating of the company if such a mix is unfavourable.

Consolidation and equity accounting

One aspect of disclosure which has the potential of being compromised, but where such non-compliance would be indeterminate from the information included in the annual financial statements, is the requirement of AC121.16 that where consolidation or equity accounting is not appropriate,

(1) the details of investments that represent a significant proportion of the insurer's net assets be disclosed,

(2) the carrying values in aggregate be categorised in those over which the insurer has:
   a) the ability to exercise control
   b) joint control
   c) significant influence
   d) no influence.

Where a company offers no such disclosure in this regard, one of two conclusions is applicable:
Optional taxation disclosure

Another disclosure attribute worth mentioning is the optional disclosure recommended by AC121.35 of the tax charge relating to each of the individual policyholder fund, the company policyholder fund and the corporate fund. It is certain that all of the companies in the sample have such information, as they are required to submit it to the South African Revenue Service. However, there is not one instance of compliance with this optional requirement. Again, this is conceivably the result of one, or both, of the following reasons:

1. Companies are loath to disclose any more than the minimum required.
2. Companies perceive this disclosure as trivial and of little value.

It is noteworthy that in the UK, taxation attributable to the shareholders' funds and the policyholders' funds is required to be shown separately.

Summary

Given that the local standard is fairly simplistic in its disclosure requirements when compared to its international equivalents, it is disconcerting to note the instances of non-disclosure identified above, albeit that they are limited. It would no doubt be useful if life insurance companies explained in their financial statements why they have deviated from the required disclosure when they do so. Users may then be able to make an informed decision as to the justification for the omission. It is incumbent upon the auditors of the respective life insurance companies to ensure that their clients provide full disclosure where this is required, and that their clients justify the omission of
Hypothesis 2
Compliance with international standards

The disclosure scores for all of the companies were subjected to ANOVA testing, with the years 1993 to 1997 as the treatment variables, and the respective reporting benchmarks as the blocking variables. The data was also tested for interaction (i.e. whether or not any combination of year and benchmark yielded a result that was significantly different from the rest). Both the disclosure scores and the results of the ANOVA tests are included in Appendices E and G respectively. The ANOVA test results in respect of this hypothesis may be summarised as follows:

- The F-value for the variation between benchmarks (441,71) far exceeded the critical F-value (3,06), implying that at least one benchmark's mean differed from the rest.
- Scheffe's method showed that, at a 95% level of confidence, significant differences exist between the South African standard and the United Kingdom standard (absolute value of difference of 40,74 against a critical range of 13,22), and between the South African standard and the Australian standard (absolute value of difference of 42,70 against the same critical range).
- The difference between the United Kingdom standard and the Australian standard was not significant (absolute value of difference of 1,97 against the same critical value above).

These results suggest that the South African standard is inadequate relative to the other two benchmarks, since the disclosure provided by South African life insurance companies in terms of local disclosure requirements has been shown to be significantly different from that required by the international benchmarks used. This is further supported by the fact that the difference in the extent of compliance by South African life insurance companies between the two international benchmarks was not significant (i.e. at a 95% level of confidence, the extent of compliance with these standards was equally poor).

It would therefore be useful to identify those requirements of the international benchmarks that were not satisfied by the South African companies.
United Kingdom

Non-compliance with the United Kingdom benchmark was quite pervasive. This was a result of the considerable detail required by the United Kingdom standard. There were also a number of disclosure attributes for which compliance was indeterminate. Only those attributes with which companies did not comply are tabled below; for the reasons noted in Chapter 3, indeterminate attributes are not included.

Table 4: Instances of disclosure non-compliance - United Kingdom: 1997

<table>
<thead>
<tr>
<th>Standard reference</th>
<th>Disclosure required</th>
<th>Rate of compliance</th>
<th>Companies with omissions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1Sch.7(3)</td>
<td>a) Gross premiums written</td>
<td>9% All but Metropolitan</td>
<td></td>
</tr>
<tr>
<td>1Sch.7(3)</td>
<td>b) Outward reinsurance premiums</td>
<td>9% All but Metropolitan</td>
<td></td>
</tr>
<tr>
<td>1Sch.2(3)</td>
<td>Unrealised gains on investments [may also be shown in a &quot;revaluation reserve&quot;]</td>
<td>64% Partial compliance by Metropolitan, Momentum, Norwich, Old Mutual, Sage, Sanlam, Southern, Aflife</td>
<td></td>
</tr>
<tr>
<td>1Sch.7(3)</td>
<td>Claims incurred, net of reinsurance</td>
<td>91% Momentum</td>
<td></td>
</tr>
<tr>
<td>1Sch.7(3)</td>
<td>a) Claims paid</td>
<td>9% All but Metropolitan</td>
<td></td>
</tr>
<tr>
<td>1Sch.7(4)</td>
<td>Changes in Provisions for linked liabilities</td>
<td>9% All but Sanlam</td>
<td></td>
</tr>
<tr>
<td>1Sch.2(3)</td>
<td>Bonuses and rebates, net of reinsurance</td>
<td>0% All</td>
<td></td>
</tr>
<tr>
<td>1Sch.2(3)</td>
<td>Net operating expenses</td>
<td>82% Momentum</td>
<td></td>
</tr>
<tr>
<td>1Sch.2(3)</td>
<td>Investment expenses and charges</td>
<td>5% Partial compliance by Commercial Union. All others.</td>
<td></td>
</tr>
<tr>
<td>1Sch.2(3)</td>
<td>Transfers to the fund for future appropriations</td>
<td>10% All but Sanlam</td>
<td></td>
</tr>
<tr>
<td>ABI.176</td>
<td>Tax attributable to shareholders’ profit</td>
<td>10% All but Sanlam</td>
<td></td>
</tr>
<tr>
<td>1Sch.2(3)</td>
<td>Investment income</td>
<td>15% Partial compliance by Sanlam. All others but for Commercial Union.</td>
<td></td>
</tr>
<tr>
<td>1Sch.2(3)</td>
<td>Unrealised gains on investments [may also be shown in a &quot;revaluation reserve&quot;]</td>
<td>25% Partial compliance by Sanlam. All others but for Liberty.</td>
<td></td>
</tr>
<tr>
<td>1Sch.2(3)</td>
<td>Investment expenses and charges</td>
<td>5% Partial compliance by Commercial Union. All others.</td>
<td></td>
</tr>
<tr>
<td>1Sch.11</td>
<td>Assets held to cover linked liabilities</td>
<td>0% All</td>
<td></td>
</tr>
<tr>
<td>1Sch.11</td>
<td>Reinsurers' share of technical provisions</td>
<td>0% All</td>
<td></td>
</tr>
<tr>
<td>1Sch.11</td>
<td>Deferred acquisition costs</td>
<td>0% All</td>
<td></td>
</tr>
<tr>
<td>1Sch.11</td>
<td>Include managed funds in the company’s balance sheet [per SA GAAP - as a footnote to the balance sheet]</td>
<td>45% Commercial Union, Fedsure, Metropolitan, Sage, Southern, Aflife</td>
<td></td>
</tr>
</tbody>
</table>
Liabilities
Fund for future appropriations 59% Liberty, Metropolitan, Momentum, old Mutual. Partial compliance by Southern.

Technical provisions
Claims outstanding 0% All

Technical provisions for linked liabilities 9% All but Sanlam

Notes
Accounting policies relating to:
Premiems 95% Partial compliance by Aflife
Bonuses 0% All
Investments
-investment income and expenses 45% Metropolitan, Momentum. All others partial compliance but for Commercial Union.

-investment gains 82% Metropolitan, Sanlam

Long term business provision

Valuation method 91% Commercial Union

Implicit or explicit provision for reversionary bonuses 68% Old Mutual, Aflife. Partial compliance by Metropolitan, Momentum, Sage.

Allocation of surpluses and fund for future appropriations 27% All but Norwich, Sage and Sanlam

Gross up of transfer to shareholder's profit from technical account by attributable tax.
Deferred acquisition costs 0% All

Segmental analysis differentiating between:

a) Gross premiums written
Recurring and single premiums 0% All
Non-participating business 0% All
Participating business 0% All
Linked business

b) Gross new business premiums
0% All
Basis of new business recognition 0% All
Reinsurance payable in respect of long term business 9% All but Metropolitan

Investment return summary

Long term insurance business 82% Sage, Southern
Investment income
Income from land and buildings
| 1Sch.73(4) | Income from listed investments | 73% Southern, Aflife. Partial compliance by Commercial Union, Fedsure. |
| 1Sch.73(4) | Income from other investments | 86% Southern. Partial compliance by Fedsure. |
| 1Sch.73(4) | Gains on the realisation of investments | 50% Momentum. Partial compliance by all others except Commercial Union. |
| 1Sch.Part1 | Detail on investment expenses and charges | 9% All but Commercial Union |
|            | Unrealised gains on investments | 59% Partial compliance by all except Commercial Union, Momentum with full compliance |
|            | Net investment return included in the long-term business technical account | 36% Fedsure, Metropolitan, Norwich, Old Mutual, Sage, Southern, Aflife |
|            | Total investment return | 64% Old Mutual, Southern. Partial compliance by Fedsure, Momentum, Norwich, Aflife. |
|            | Movement in prior year's provision for claims outstanding | 0% All |
| 1Sch.78    | Commissions paid | 82% Momentum, Sage |
| 1Sch.28(3) | For a) [shares etc] and b) [debt securities] above, the following segmental reporting: | 86% Partial compliance by Metropolitan, Norwich, Southern |
|            | Those listed on a recognised investment exchange | 0% All |
|            | Other listed investments | 9% All but Sanlam |
|            | Total listed investments | 77% Liberty, Old Mutual. Partial compliance by Southern. |
| 1Sch.28(3) | Assets held to cover linked liabilities | 0% All |
|            | Policyholder liabilities and fund for future appropriations | 0% All |
|            | Segmented as follows: | 0% All |
|            | Claims outstanding | 0% All |
|            | Technical provision for linked liabilities | 9% All but Sanlam |
|            | Fund for future appropriations | 77% Liberty, Old Mutual. Partial compliance by Southern. |
| 1Sch.46(2) | Long term business provision | 0% All |
|            | Principal assumptions: | 0% All |
|            | Mortality | 0% All |
| ABI,157    | Above to be segmented between the following classes of business [Life, Pensions, Annuities - refer Appendix D] | 0% All |
|            | Changes in bases or assumptions since previous year | 73% Old Mutual, Metropolitan, Southern |
Principal omissions

The detail of the disclosure attributes omitted from the 1997 annual financial statements of the sample of life insurance companies is evident from the tabulations above. While South African life insurance companies cannot necessarily be expected to comply with this level of detail, attempts could perhaps be made to provide the following generic disclosures, which can be derived from the detailed omissions above:

- **Gross premiums and claims, with reinsurance shown separately.** The reasons for these omissions have already been considered under “Hypothesis 1” earlier in this chapter.
- **Detail on the actual balances of and changes in the actuarial liabilities, differentiating between the provision for claims outstanding, the provision for linked liabilities and the long term business provision.** These attributes have been omitted from disclosure by South African life companies simply because this level of detail is not required by any standard. There may be an argument from some quarters that only an actuary could reasonably be expected to understand these types of disclosures - however, one of the premises of financial reporting is the assumption that “users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. However, information about complex matters that should be included in the financial statements because of its relevance to the economic decision-making needs of users should not be excluded merely on the grounds that it may be too difficult for certain users to understand” (AC000, 1990).
- **Following from the above, the principal assumptions relating to mortality in the calculation of the actuarial liabilities, segmented between the various classes of business (life, pensions, annuities, further differentiating between participating and non-participating business).** Disclosure of these assumptions is necessary to understand the basis of the determination of the amounts indicated in the previous point.
- **Detail on expenses, specifically including, and disclosing separately, investment expenses and charges.** Expense control is one of the major profit drivers in the operating profit of a life company. The separate
Disclosure is expenses relating to investment income is necessary, as investment management is a separate part of the life insurance business, and should therefore be capable of being evaluated as such.

- **the amount transferred to shareholders as a result of life operations** (the "fund for future appropriations"). It is important to indicate to both policyholders and shareholders the amount accruing to shareholders from the policyholders. The fund for future appropriations is discussed in Chapter 2. In most South African life company accounts, the fund for future appropriations has arisen purely as the "balance of excess", being that portion of the actuarial surplus not directly attributable to share capital, distributable reserves and non-distributable reserves. Explicit disclosure of transfers to this "balance of excess" have not been evident.

- **detail on the basis of allocation of surpluses and the fund for future appropriations.** This follows from the point above, and is necessary both to enable extrapolation of shareholder surpluses, as well as to render the basis of such transfers comparable between companies.

- **separate identification of the investment income, unrealised gains on investments, investment expenses and charges and taxation attributable to shareholders.** While profit from life operations is transferred from policyholders' funds to shareholders' funds, the shareholders also earn a return on the assets in the shareholders' fund. This type of disclosure enables users to assess the performance of the shareholders' "portfolio" relative to other benchmarks.

- **segmentation of assets on the basis of the kinds of policies that they support.** Disclosure of this information provides evidence of the exposure of shareholder's capital to policyholders. It also illustrates the mix of products of the life insurer, and so makes earnings predictions somewhat more educated, if the profitability and investment return on these products can be determined.

- **accounting policy relating to bonuses.** Since shareholders often participate in certain reversionary bonuses, this attribute also aids the analysis and extrapolation of shareholder earnings.

- **the amounts charged for bonuses and rebates to be explicitly disclosed.** In South Africa, these amounts are implicit in the Financial Soundness Valuation ("FSV") method of determining actuarial liabilities. Given that some portion of profit attributable to shareholders is a function of bonuses...
and rebates declared to policyholders, disclosure of such information is useful.

- **deferred policy acquisition costs.** These deferrals arise as a result of the profit recognition policies of a life company. In South Africa, the FSV determines how profit is released over time; hence it is reasonable to think that deferred acquisition costs are inherent in the actuarial liabilities. Useful disclosure might therefore be to indicate the extent of such cost deferral in the FSV basis.

- **segmental analysis of gross premiums written, further differentiating between existing business and new business.** This disclosure would give an indication of the increase in market share of the life company when compared to others. However, the measurement and recognition of new business may well have to be standardised, or the basis of new business recognition would need to be clearly described in order to render such a number comparable with other companies.

- **an investment returns summary, showing separately the gains from the realisation of investments, for returns attributable to policyholders and shareholders respectively.** Investment return is conceivably one of the more volatile aspects of a life insurer’s profit. Such a summary enables the user to accurately assess the impact of investment return on shareholder and policyholder funds. In South Africa, realised and unrealised gains have conventionally been aggregated.

**Summary**

The UK benchmark is clearly far more exacting in its disclosure requirements than either the South African standard, or the Australian benchmark. The most obvious reason for the omissions by South African insurers is simply that they have never been and are still not required to disclose that type of detail, despite the merits thereof. However, it is probably equally true that the UK standard’s level of detail could be overwhelming to users.

**Australia**

While the disclosure requirements of the Australian benchmark are somewhat less onerous than those of the UK, there remain several similarities in the nature of non-compliance by South African life companies. This presents a clear indication of the specific areas in which the current South African standard is deficient. The instances of non-compliance with the Australian standard which are similar to the instances of non-compliance with the UK standard are noted as such in the commentary that follows the table below:
### Table 5: Instances of non-compliance - Australia: 1997

<table>
<thead>
<tr>
<th>Standard reference</th>
<th>Disclosure required</th>
<th>Rate of compliance</th>
<th>Companies with omissions</th>
</tr>
</thead>
<tbody>
<tr>
<td>ED73.5.2</td>
<td>The financial report of a life insurer should include:</td>
<td>73%</td>
<td>Norwich, Sage, Aflife</td>
</tr>
<tr>
<td></td>
<td>b) disclosure of movements in equity in a note or in the statement of financial performance</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>d) statement of cash flows</td>
<td>91%</td>
<td>Commercial Union</td>
</tr>
<tr>
<td>ED73.15.2</td>
<td>The financial report must include a brief description of the tax regime applying to the life insurer and disclose the basis on which carrying amounts of deferred tax assets and liabilities have been determined.</td>
<td>18%</td>
<td>All but Sanlam; partial compliance by Liberty and Southern</td>
</tr>
<tr>
<td>ED73.16</td>
<td>Financial performance disclosures</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>c) investment revenue, showing revenue from:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- equity securities</td>
<td>91%</td>
<td>Southern</td>
</tr>
<tr>
<td></td>
<td>- debt securities</td>
<td>91%</td>
<td>Southern</td>
</tr>
<tr>
<td></td>
<td>- properties</td>
<td>82%</td>
<td>Southern, Sage</td>
</tr>
<tr>
<td></td>
<td>- other</td>
<td>45%</td>
<td>Commercial Union, Fedsure, Old Mutual, Sanlam, Southern, Aflife</td>
</tr>
<tr>
<td></td>
<td>e) outwards reinsurance expense</td>
<td>9%</td>
<td>All but Metropolitan</td>
</tr>
<tr>
<td></td>
<td>f) operating expenses, showing:</td>
<td>0%</td>
<td>All</td>
</tr>
<tr>
<td></td>
<td>- policy acquisition expenses</td>
<td>0%</td>
<td>All</td>
</tr>
<tr>
<td></td>
<td>- policy maintenance expenses</td>
<td>0%</td>
<td>All</td>
</tr>
<tr>
<td></td>
<td>- investment management expenses</td>
<td>0%</td>
<td>All</td>
</tr>
<tr>
<td></td>
<td>- other</td>
<td>91%</td>
<td>Momentum</td>
</tr>
<tr>
<td></td>
<td>g) that part of the change in policy liabilities that relates to policy obligations other than those arising from the inflow or outflow of components of premiums akin to deposits</td>
<td>9%</td>
<td>All but Sanlam</td>
</tr>
<tr>
<td></td>
<td>h) investment revenues paid or allocated to policyholders, including the current year allocation of participating policyholder benefits</td>
<td>45%</td>
<td>Full compliance by Commercial Union. Non-compliance by Metropolitan and Sage. Partial compliance by all others.</td>
</tr>
<tr>
<td>ED73.17</td>
<td>Financial position disclosures</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ED73.17.1</td>
<td>Assets: The following must be disclosed in the broad order of their liquidity</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>c) reinsurance recoveries receivable</td>
<td>0%</td>
<td>All</td>
</tr>
<tr>
<td>ED73.17.1.3</td>
<td>(OPTIONAL) Disclose segmental analysis of investment categories above</td>
<td>73%</td>
<td>Commercial Union, Sage, Southern</td>
</tr>
<tr>
<td>ED73.17.2</td>
<td>The following components of policy liabilities must also be shown:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>a) future policy benefits</td>
<td>0%</td>
<td>All</td>
</tr>
<tr>
<td></td>
<td>b) future bonuses</td>
<td>0%</td>
<td>All</td>
</tr>
<tr>
<td></td>
<td>c) future expenses</td>
<td>5%</td>
<td>Partial compliance by Sage</td>
</tr>
<tr>
<td></td>
<td>d) future planned margins of revenue over expenses</td>
<td>0%</td>
<td>All</td>
</tr>
<tr>
<td></td>
<td>e) future charges for acquisition costs</td>
<td>0%</td>
<td>All</td>
</tr>
</tbody>
</table>
1) balance of future premiums

Restrictions on assets
The restrictions attaching to assets held for the benefit of policyholders must be disclosed

ED73 17.5

Guaranteed or assured returns of funds invested
The amount of policy liabilities which related to guaranteed or assured returns of funds invested must be disclosed

ED73 17.7

Managed funds and other fiduciary activities
A life insurer must disclose the nature and amount of its involvement in managed funds and trust activities and whether arrangements exist to ensure that such activities are managed independently from its other activities

ED73 18

Actuarial information

ED73 18.1

The following must be disclosed in the notes to the financial statements:

C) whether the amount of policy liabilities has been determined in accordance with the methods and assumptions disclosed in the financial report and with the standards of the [Actuarial Society of South Africa]

d) whether the actuary is satisfied as to the accuracy of the data from which the amount in c) has been determined

ED73 18.2

Disclosure of assumptions
A summary of the key assumptions used in determining policy liabilities must be disclosed in the notes to the financial statements, including:

a) discount rates, asset mix, and inflation rates

b) rates of commission

c) profit carriers used for each major product group

d) future maintenance and investment expenses, the rate of inflation applicable to them and any automatic indexation benefits and premiums

e) rates of taxation

f) mortality and morbidity, by reference to the identity of the tables

g) rates of discontinuance

h) rates of growth of the unit prices in respect of unit-linked benefits

I) the basis of allocating future participating benefits

j) rate of future supportable participating benefits

k) the crediting philosophy adopted in determining future supportable participating benefits and how it compares with the life insurer's actual practice

0% All

0% All

0% All

45% Commercial Union, Fedsure, Metropolitan, Sage, Southern, Alife

91% Commercial Union

9% All but Sanlam

27% All but Momentum, Sage and Sanlam

0% All

0% All

27% All but Momentum, Sage and Sanlam

0% All

0% All

0% All

0% All

0% All

0% All

0% All
Investment linked and non-investment linked business

Information required by paragraph 19.1 [disaggregation of income and expenses, assets and liabilities for the life fund(s) and the shareholders' fund] must be disaggregated as between those amounts relating to investment linked business and those relating to non-investment linked business

9% All but Sanlam

Principal omissions

While the detail of the non-compliance is clear from the table above, these may be summarised into the following principal omissions (items in bold type denote similar omissions to the UK benchmark):

- **reinsurance premiums and reinsurance benefits.** This has already been considered under the South African omissions earlier.

- **description of taxation and deferred taxation regime applicable to the insurer.** Taxation is one of the determinants of profit, and the taxation regime (the four funds principle, as well as a separate tax on retirement funds) applicable to insurance companies in South Africa differs from the conventional normal company tax. Inasmuch as this information would be needed to appreciate the effect of taxation on the profit of an insurer, it should be provided. However, since the South African statement makes disclosure of the taxation charge relating to the four funds optional, insurers have no compulsion to show it.

- **operating expense detail.** The Australian benchmark requires policy acquisition and maintenance expenses to be separately disclosed, over and above the UK requirement of disclosure of investment management expenses. In South Africa, these expenses are implicitly measured in the valuation of the actuarial liabilities, and so are effectively hidden from the user.

- **explicit disclosure of that part of policy liabilities relating to linked business.** This type of disclosure is useful in that it illustrates the extent of the policy liabilities which do not require support by the shareholders' fund, and hence have little direct effect on profit.

- **investment revenues and participating benefits paid to policyholders.** ED73 at paragraph 16.1.2 offers the following, rather vague justification for the inclusion of this line item: "Many life insurance policies are largely investment products. Some policies combine investment and risk services, the relative proportions of which may vary as policies mature. The
investment returns paid or allocated to policyholders in their capacity as investors is a relevant disclosure to include in the financial report."

- detailed breakdown of the future components of policy liabilities. These disclosures are necessary in order for the user to assess the reasonability of the bases for the valuation of the actuarial liabilities. Clear disclosure of these estimated attributes renders the amount of the actuarial liabilities less vulnerable to implicit manipulation, and hence the profit figure derived as a result of the movement in the actuarial liabilities is more robustly reported.

- restrictions of assets and exposure of capital relating to policyholder funds. For certain types of policies, investments may only be made into specific types of instruments. An insurer may therefore have an uncharacteristic weighting towards a specific type of financial instrument. The disclosure of restrictions attached to the investment of policyholder funds would explain this anomaly. Furthermore, since the shareholders’ fund is exposed to risk when the insurer guarantees returns to policyholders, the extent of this exposure should be quantified and disclosed.

- detailed disclosure of the actuarial assumptions. As noted under the consideration of the UK benchmark above, the disclosure of these assumptions goes some way to rendering the actuarial liabilities slightly more understandable and comparable with other insurance companies.

Summary

The over-simplified nature of the disclosure requirements of South Africa’s AC121 is the primary reason for non-compliance with so many of the disclosure requirements of the Australian benchmark. There is some overlap between the omissions from the UK benchmark, and the omissions from the Australian one. These omissions indicate areas which require urgent attention in South African reporting, since the disclosure of those attributes is clearly valuable to users.
Hypothesis 3
Change in the extent of disclosure from 1993 to 1995

The ANOVA test results in respect of this hypothesis may be summarised as follows:

- The F-value for the variation between years (14,16) exceeded the critical F-value (2.43), implying that at least one year's mean differed from the rest.
- Scheffe's method showed that, at a 95% level of confidence, significant differences in mean disclosure scores existed between 1993 and each of 1995, 1996 and 1997. The absolute values of the differences and the critical ranges can be seen in Appendix G.

The implication of this result is that, based upon the disclosure scores compiled, there was not a significant change in the extent of disclosure between 1993 and 1994. In spite of the changes to the reporting requirements brought about by the amendment to the South African Companies Act, as described in Chapter 1, the effect on the extent of disclosure by the sample of companies was not immediate. From 1995 onwards, the difference did have statistical significance. The reason for these observations is clear: AC121 and the repeal of Part V to Schedule 4 of the Companies Act was effective for financial years commencing on or after 1 January 1994. Only Commercial Union, Norwich, Fedsure and Liberty would have had occasion to comply with the revised disclosure requirements in their 1994 annual reports. The result is therefore within expectations.

Sage

The trend in Sage's aggregate disclosure score, as shown in Appendix E, is something of an anomaly, since it does not exhibit the same change in the extent of its disclosure compliance from 1993 to 1995 as the other companies in the sample. The Sage Group only began including a separate report on Sage Life, including the requisite disclosures specific to the insurance industry, from 1996. The insurance disclosures were largely absent from the group annual report, which explains the poor extent of compliance by Sage in 1995.

Incremental disclosure

Disclosures which came to the fore in 1995, which were previously absent in 1993, are considered below:
### Table 6: Incremental disclosure (1993/5) - South Africa

<table>
<thead>
<tr>
<th>Standard reference</th>
<th>Disclosure required</th>
<th>Total incidence of incremental disclosure</th>
<th>Companies affected by incremental disclosure</th>
</tr>
</thead>
<tbody>
<tr>
<td>AC121.21</td>
<td>Actuary's report to include a statement of actuarial values of assets and liabilities</td>
<td>8</td>
<td>Commercial Union, Fedsure, Metropolitan, Momentum, Norwich, Old Mutual, Southern, Aflife</td>
</tr>
<tr>
<td>AC121.21</td>
<td>Actuary's report in accordance with ASSA guidelines</td>
<td>8</td>
<td>As above</td>
</tr>
<tr>
<td>AC121.25</td>
<td>Major components of investment income</td>
<td>5.5</td>
<td>Fedsure, Metropolitan, Momentum, Old Mutual, Aflife, Partial increment by Sage</td>
</tr>
<tr>
<td>AC121.13(d)</td>
<td>Statement of cash flow information</td>
<td>5</td>
<td>Fedsure, Liberty, Momentum, Old Mutual, Aflife</td>
</tr>
<tr>
<td>AC121.15</td>
<td>Segmental analysis of total equity investment</td>
<td>6</td>
<td>Fedsure, Liberty, Metropolitan, Momentum, Old Mutual, Aflife</td>
</tr>
<tr>
<td>AC121.27(e)</td>
<td>Group member withdrawal payments</td>
<td>4</td>
<td>Commercial Union, Fedsure, Southern, Aflife</td>
</tr>
<tr>
<td>AC121.14©</td>
<td>All other material movements</td>
<td>1</td>
<td>Southern</td>
</tr>
<tr>
<td>AC121.27(f)</td>
<td>Group scheme terminations</td>
<td>2</td>
<td>Commercial Union, Fedsure, Southern, Aflife</td>
</tr>
<tr>
<td>AC121.36(a)</td>
<td>Aggregate directors emoluments</td>
<td>2</td>
<td>Old Mutual, Sanlam</td>
</tr>
<tr>
<td>AC121.36(b)</td>
<td>Auditors remuneration, distinguishing between the fee for the audit, other services and expenses</td>
<td>2</td>
<td>As above</td>
</tr>
<tr>
<td>AC121.38</td>
<td>Fact that insurer manages funds on behalf of other parties and the fair value of such assets</td>
<td>1</td>
<td>Disclosure by Momentum, Sanlam, Decrement by Aflife</td>
</tr>
<tr>
<td>AC121.13(a)</td>
<td>Directors report</td>
<td>0</td>
<td>Old Mutual, Decrement by Liberty</td>
</tr>
<tr>
<td>AC121.13(g)</td>
<td>Actuary's report</td>
<td>1</td>
<td>Old Mutual</td>
</tr>
<tr>
<td>AC121.14(b)</td>
<td>Aggregate gains or losses on revaluation and on disposal of investments</td>
<td>1</td>
<td>Metropolitan</td>
</tr>
<tr>
<td>AC121.26</td>
<td>Reinsurance premiums, where material</td>
<td>1</td>
<td>Commercial Union</td>
</tr>
<tr>
<td>AC121.27(a)</td>
<td>Death and disability claims</td>
<td>1</td>
<td>As above</td>
</tr>
<tr>
<td>AC121.27(b)</td>
<td>Maturity claims</td>
<td>1</td>
<td>As above</td>
</tr>
<tr>
<td>AC121.27©</td>
<td>Annuity payments</td>
<td>1</td>
<td>As above</td>
</tr>
<tr>
<td>AC121.27(d)</td>
<td>Individual policy surrenders</td>
<td>1</td>
<td>Metropolitan</td>
</tr>
<tr>
<td>AC121.27</td>
<td>Reinsurance benefits</td>
<td>0</td>
<td>Liberty, Decrement by Momentum</td>
</tr>
<tr>
<td>AC121.33</td>
<td>Separate disclosure of sales remuneration</td>
<td>0</td>
<td>Increment by Old Mutual</td>
</tr>
<tr>
<td>AC121.33</td>
<td>Operating/management expenses</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Note:** The companies identified above clearly exclude those that complied with the disclosure requirements in both 1993 and 1995

---

A review of disclosure in the annual financial reports of life insurance companies in South Africa: 1999
Principal increments

The most notable improvements in disclosure compliance with AC121 from 1993 to 1995 are:

- the inclusion of an actuary's report
- the disclosure of a statement of the actuarial values of assets and liabilities in the actuary's report
- a breakdown of the major components of investment income
- a statement of cash flow information
- segmental analyses of the total equity investment.

The formalisation of AC121 as a statement of GAAP compelled some companies to begin to disclose the above attributes, even though they were recommended by AC204, which was a guideline only. Therefore, the principal reason for the developments noted in the table above was the watershed in 1994, where AC121 became effective and Part V to Schedule 4 of the Companies Act was repealed.

Some interesting anomalies emerge from the tabulation too, being the instances where less is disclosed than before. Momentum ceased to disclose sales remuneration separately, and it ceased to show operating/management expenses, preferring instead to proffer only the minimum expense disclosure required by the Companies Act. This remains permissible in terms of section 286(3) of the Companies Act, which requires that "[t]he annual financial statements of a company shall, in conformity with generally accepted accounting practice, fairly present the state of affairs of the company and its business as at the end of the financial year concerned and the profit or loss of the company for that financial year and shall for that purpose be in accordance with and include at least the matters prescribed by Schedule 4, in so far as they are applicable, and comply with any other requirements of this Act". Since the requirement is not to comply with statements of GAAP, Momentum's non-disclosure of some attributes required by AC121 was technically permissible. It did, however, render their financial statements less useful, since the analysis of the profit drivers was compromised.
United Kingdom

A tabulation of the incremental disclosures by the sample of South African life insurance companies in terms of the UK benchmark from 1993 to 1995 is included in Appendix F. The following main additions were noted:

- accounting policy relating to claims
- note relating to investment gains
- disclosure of the actuarial valuation method (naming and briefly describing the method used)
- disclosure of whether the provision for bonuses is explicit or implicit in the actuarial valuation
- disclosure of income from other investments and land and buildings
- indication of a "fund for future appropriations" or "balance of excess"
- disclosure of changes in bases or assumptions used in the actuarial valuation since the previous year, or an indication of no such change.

While it is commendable that these additional disclosures were made, it is fair to note that they were probably precipitated by the parallel requirements of the amended South African disclosures. There is no indication of meaningful incremental disclosure for attributes in the UK benchmark which do not form part of the South African standard. However, it should also be borne in mind that the UK Schedule 9A was only effective from December 1995, and hence one would expect more incremental disclosure for the 1995 to 1997 period if South African life insurance companies were indeed looking to international benchmarks for guidance.
## Table 7: Incremental disclosure (1993/5) - Australia

<table>
<thead>
<tr>
<th>Standard reference</th>
<th>Disclosure required</th>
<th>Total incidence of incremental disclosure</th>
<th>Companies affected by incremental disclosure</th>
</tr>
</thead>
<tbody>
<tr>
<td>ED73 5.2</td>
<td>b) disclosure of movements in equity</td>
<td>3</td>
<td>Liberty, Metropolitan, Momentum</td>
</tr>
<tr>
<td></td>
<td>c) Statement of cash flows</td>
<td>5</td>
<td>Fedsure, Liberty, Momentum, Old Mutual, Aflife</td>
</tr>
<tr>
<td>ED73 15.2</td>
<td>Description of tax regime and basis on which carrying amounts of deferred tax assets and liabilities have been determined.</td>
<td>1</td>
<td>Sanlam</td>
</tr>
<tr>
<td>ED73 16©</td>
<td>Investment revenue, showing revenue from:</td>
<td>5</td>
<td>Fedsure, Metropolitan, Momentum, Old Mutual, Aflife</td>
</tr>
<tr>
<td></td>
<td>- equity securities,</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- debt securities,</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- properties</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ED73 16(e)</td>
<td>Outwards reinsurance expense</td>
<td>1</td>
<td>Metropolitan</td>
</tr>
<tr>
<td>ED73 16(g)</td>
<td>That part of the change in policy liabilities that relates to obligations other than those arising from the inflow or outflow of components of premiums akin to deposits.</td>
<td>1</td>
<td>Sanlam</td>
</tr>
<tr>
<td>ED73 16(h)</td>
<td>Investment revenues paid or allocated to policyholders, including the current year allocation of participating policyholder benefits.</td>
<td>1</td>
<td>Partial increment by Fedsure, Old Mutual.</td>
</tr>
<tr>
<td>ED73 17.2</td>
<td>Policy liabilities and other liabilities, by nature, must be disclosed in the broad order of their liquidity</td>
<td>6</td>
<td>Fedsure, Metropolitan, Momentum, Old Mutual, Sage, Aflife</td>
</tr>
<tr>
<td>ED73 17.6</td>
<td>The amount of equity retained as solvency reserves and the basis of establishing the amount.</td>
<td>6</td>
<td>Fedsure, Liberty, Metropolitan, Norwich, Old Mutual, Sanlam.</td>
</tr>
<tr>
<td>ED73 17.7</td>
<td>Nature and amount of involvement in managed funds and trust activities.</td>
<td>2</td>
<td>Momentum, Sanlam.</td>
</tr>
<tr>
<td>ED73 18.1©</td>
<td>Whether the amount of policy liabilities has been determined in accordance with the methods and assumptions disclosed in the financial report and with the standard of the [Actuarial Society of South Africa]</td>
<td>7</td>
<td>All but Commercial Union, Momentum, Sage, Sanlam.</td>
</tr>
</tbody>
</table>

### Principal increments

The inclusion of a statement of cash flows, a breakdown of investment revenue and policy liabilities is a result of the formalised requirements of the South African standard, rather than any cognisance of international standards.

### Voluntary disclosure

The extent of voluntary disclosure was assessed by considering the extent to which the sample of South African life insurance companies complied with requirements of the international benchmarks used which were not included in the South African standard. Few instances of such compliance were noted (refer to the tabulations above). Clearly, South African companies were

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A review of disclosure in the annual financial reports of life insurance companies in South Africa: 1999
neither taking much initiative in terms of additional disclosure, nor were they taking any cues from developments abroad.
Hypothesis 4
Compliance with benchmarks since 1995

The ANOVA results given under Hypothesis 3 above indicate that the differences in the mean disclosure scores between 1994, 1995, 1996 and 1997 are not statistically significant, except for the difference between 1997 and 1994.

Since only four of the sample of eleven companies were required to comply with the changes to the South African disclosure requirements in their 1994 annual reports, the difference between 1997 and 1994 is expected, as the extent of compliance with the benchmarks in 1994 was on a par with the extent of compliance in 1993 (see Hypothesis 3 above).

After taking the observed anomaly above into account, it is clear that there has been no significant change in the extent of compliance with the respective benchmarks since 1995. Notwithstanding that result, the incremental disclosures noted over the period are tabulated below:

South Africa

Table 8: Incremental disclosure (1995-7) - South Africa

<table>
<thead>
<tr>
<th>Standard reference</th>
<th>Disclosure required</th>
<th>Total incidence of incremental disclosure</th>
<th>Companies affected by incremental disclosure</th>
</tr>
</thead>
<tbody>
<tr>
<td>AC121.13</td>
<td>g) actuary’s report</td>
<td>1</td>
<td>Sage</td>
</tr>
<tr>
<td>AC121.38</td>
<td>Has the fact that the insurer manages assets on behalf of other parties been disclosed together with the fair value of those managed assets&gt;</td>
<td>1</td>
<td>Liberty</td>
</tr>
<tr>
<td>AC121.21</td>
<td>Does the report prepared by the actuary include a statement of the actuarial values of assets and liabilities?</td>
<td>1.5</td>
<td>Liberty, Sage. Partial decrement by Southern.</td>
</tr>
<tr>
<td>AC121.21</td>
<td>Is the actuary's report in accordance with the guidelines issued by the Actuarial Society of South Africa, which includes, in addition to the requirement above, unless included in the financial statements:</td>
<td>2</td>
<td>Liberty, Sage.</td>
</tr>
<tr>
<td>AC121.14</td>
<td>Do the details of the movement in the life fund distinguish between: a) Transfers to or from the income or operating statement?</td>
<td>1</td>
<td>Metropolitan, Sage. Decrement by Southern.</td>
</tr>
</tbody>
</table>

A review of disclosure in the annual financial reports of life insurance companies in South Africa: 1999
Results

The anomalous decrements warrant some comment. Liberty ceased presenting a directors' report since the content of such a report had been included in the chairman's report.

It is clear that the lack of development in the standard setting process in South Africa pertaining to life insurance companies has led to the stagnation of the extent of information disclosed.

United Kingdom

The tabulation of incremental disclosure by the sample of companies in terms of the UK benchmark is included in Appendix F. The low incidence of additional disclosure over the period 1995 to 1997 is consistent with the ANOVA result.

A little cognisance is being taken of the disclosure relating to the "fund for future appropriations", which is also known as the "balance of excess" or "unappropriated free reserves" in South Africa. This has historically been the unquantified "black box" of the life fund. It appears that some South African insurers are taking some cues from the international benchmarks and are
offering some additional disclosure in terms of showing this component of the actuarial surplus. However, until sufficient appropriate detail (relating to actuarial assumptions and shareholder entitlement to life profits) accompanies the disclosure of the amount, it will of itself not offer a great deal of value to the user.

**Australia**

Table 9: Incremental disclosure (1995-7) - Australia

<table>
<thead>
<tr>
<th>Standard reference</th>
<th>Disclosure required</th>
<th>Total incidence of incremental disclosure</th>
<th>Companies affected by incremental disclosure</th>
</tr>
</thead>
<tbody>
<tr>
<td>ED73 5.2</td>
<td>b) disclosure of movements in equity in a note or in the statement of financial performance</td>
<td>-1</td>
<td>Southern. Decrement by Norwich, Sage.</td>
</tr>
<tr>
<td>ED73 15.2</td>
<td>The financial report must include a brief description of the tax regime applying to the life insurer and disclose the basis on which carrying amounts of deferred tax assets and liabilities have been determined.</td>
<td>0.5</td>
<td>Partial increment by Sanlam.</td>
</tr>
<tr>
<td>ED73 16</td>
<td>Financial performance disclosures</td>
<td>1</td>
<td>Sage</td>
</tr>
<tr>
<td></td>
<td>a) premium revenue</td>
<td>0.5</td>
<td>Partial increment by Sage</td>
</tr>
<tr>
<td></td>
<td>f) operating expenses, showing:</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>- claims expense relating to death and disability risk exposures</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>h) investment revenues paid or allocated to policyholders, including the current year allocation of participating policyholder benefits</td>
<td>1</td>
<td>Partial increments by Momentum, Liberty.</td>
</tr>
<tr>
<td>ED73 17.3</td>
<td>(OPTIONAL) Disclose segmental analysis of investment categories above</td>
<td>2</td>
<td>Metropolitan, Old Mutual</td>
</tr>
<tr>
<td>ED73 17.2</td>
<td>c) future expenses</td>
<td>0.5</td>
<td>Partial increment by Sage</td>
</tr>
<tr>
<td>ED73 17.6</td>
<td>The amount of equity retained as solvency reserves and the basis of establishing the amount must be disclosed</td>
<td>5</td>
<td>Commercial Union, Momentum, Sage, Southern, Aflife</td>
</tr>
<tr>
<td>ED73 17.7</td>
<td>A life insurer must disclose the nature and amount of its involvement in managed funds and trust activities and whether arrangements exist to ensure that such activities are managed independently from its other activities</td>
<td>1</td>
<td>Liberty</td>
</tr>
<tr>
<td>ED73 18.1</td>
<td>a) the effective date of the actuarial report on policy liabilities and solvency reserves</td>
<td></td>
<td>Sage</td>
</tr>
<tr>
<td></td>
<td>b) the name and qualifications of the actuary</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td></td>
<td>c) whether the amount of policy liabilities has been determined in accordance with the methods and assumptions disclosed in the financial report and with the standards of the [Actuarial Society of South Africa]</td>
<td>2</td>
<td>Momentum, Sage</td>
</tr>
</tbody>
</table>
d) whether the actuary is satisfied as to the accuracy of the data from which the amount in c) has been determined.

A summary of the key assumptions used in determining policy liabilities must be disclosed in the notes to the financial statements, including:

- a) discount rates, asset mix, and inflation rates
- d) future maintenance and investment expenses, the rate of inflation applicable to them and any automatic indexation benefits and premiums

<table>
<thead>
<tr>
<th>Company</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Sanlam</td>
<td></td>
</tr>
<tr>
<td>2 Momentum, Sage</td>
<td></td>
</tr>
</tbody>
</table>

As for the South African and UK increments, the incremental disclosures under the Australian standard are also stagnant over the period 1994 to 1997. The notable exception was the disclosure of solvency reserves (which were paralleled with the "capital adequacy requirements" in South Africa). However, this is not an instance of pervasive voluntary disclosure, since disclosure of the capital adequacy requirement was included in the actuarial guidelines preceding PGN103 and 104.

Little or no development as to the nature and extent of disclosure has taken place over the period 1995 to 1997, both in terms of the requirements of the local standard, as well as the disclosure provided by the sample of companies examined.
Hypothesis 5

The influence of international standards

Hypothesis 5 poses the question as to whether or not the disclosure offered by the sample of South African life insurance companies has been influenced by the international benchmarks.

The results of Hypotheses 3 and 4 show how the extent of compliance with the respective benchmarks changed significantly from 1993 to 1995, but rather insignificantly from 1995 to 1997.

It was shown under Hypothesis 3 that the primary reasons for the increased extent of disclosure from 1993 to 1995 were the changes effected to Schedule 4 of the Companies Act, and the publication of AC121.

However, no similar protagonists of change existed in the period 1995 to 1997. There were some minor instances of incremental disclosure presented by the sample of companies in terms of the international benchmarks. These were more likely to have been the result of internal decisions on the part of South African companies to disclose certain information, rather than as the result of any specific cognisance of or compliance with international standards.

It is a logical deduction, therefore, that the United Kingdom and Australian life insurance reporting developments, standards and exposure drafts had little influence on the nature and extent of disclosure by South African life insurance companies.
Summary

The following table presents a summary of the tests conducted and their results:

<table>
<thead>
<tr>
<th>Hypotheses</th>
<th>Results</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Main problem: Hypothesis 1</strong>&lt;br&gt;H₀: The extent of disclosure satisfies the requirements of local standards.&lt;br&gt;H₁: The extent of disclosure does not satisfy the requirements of local standard.</td>
<td>Reject H₀ on the basis of the ANOVA test result. However, by 1997, all companies in the sample had compliance rates of more than 78%.</td>
</tr>
<tr>
<td><strong>Main problem: Hypothesis 2</strong>&lt;br&gt;H₀: The extent of disclosure satisfies the requirements of international standards.&lt;br&gt;H₁: The extent of disclosure does not satisfy the requirements of international standard.</td>
<td>Reject H₀ on the basis of the results of the ANOVA test. The level of compliance with the international benchmarks is significantly lower than the level of compliance with the South African standard.</td>
</tr>
<tr>
<td><strong>Sub-problem 1: Hypothesis 3</strong>&lt;br&gt;H₀: There was no significant change in the extent of disclosure between 1993 and 1995.&lt;br&gt;H₁: There was a significant change in the extent of disclosure between 1993 and 1995.</td>
<td>Reject H₀ on the basis of the results of the ANOVA test. The sample of South African companies complied better with all three benchmarks used in 1995 than in 1993.</td>
</tr>
<tr>
<td><strong>Sub-problem 2: Hypothesis 4</strong>&lt;br&gt;H₀: Companies have not complied better with benchmarks since 1995.&lt;br&gt;H₁: Companies have complied better with benchmarks since 1995.</td>
<td>Accept H₀ on the basis of the results of the ANOVA test. There was no significant change in the extent of compliance by the sample with the three standards from 1995 to 1997.</td>
</tr>
<tr>
<td><strong>Sub-problem 3: Hypothesis 5</strong>&lt;br&gt;H₀: International insurance standards have not influenced reporting by South African life companies.&lt;br&gt;H₁: International insurance standards have influenced reporting by South African life companies.</td>
<td>Accept H₀ based on the results of the tests of hypotheses 3 and 4. The significant change in the extent of compliance with the international benchmarks between 1993 and 1995 was as a result of changes to local reporting requirements. Since no significant change in the extent of compliance with the international benchmarks from 1995 to 1997 was identified, it can be surmised that the disclosure of South African life companies has not been influenced by international developments.</td>
</tr>
</tbody>
</table>
Chapter 5

A brief review of future developments in South African disclosure requirements

Actuarial disclosure

The Actuarial Society of South Africa's Professional Guidance Note (PGN) 103 is effective from 1 January 1998. The PGN details the actuarial disclosures necessary in the financial reports of life insurance companies in South Africa.

The requirements are listed in Appendix H. The additional disclosure required by this actuarial standard goes some way to narrowing the gap between the South African disclosure requirements and the international benchmarks used in this study, although much of the information required to be disclosed by the PGN is descriptive rather than quantitative, with considerable scope still being allowed for some degree of opacity in disclosure.

International standards

As mentioned in Chapter 1, the IASC added an insurance accounting project to its list of projects in April 1997. Since the discussions to date have focused mainly on measurement issues, the only tentative disclosure issue identified to date is as follows:

- Should insurance be presented net of reinsurance, or should reinsurance be presented separately?

The next step in the IASC project's development will be the production and dissemination of an "Issues Paper" in the second half of 1999.

United Kingdom developments

The ABI SORP has now been finalised (final draft dated 23 December 1998).

The final changes made to the draft SORP were principally to set in place additional rules with respect to the amortisation of traded fixed interest securities. The new development is therefore a measurement issue, and the

A review of disclosure in the annual financial reports of life insurance companies in South Africa: 1999
disclosure parameters which were assessed in this dissertation remain unaltered.

**Australian developments**

At the end of 1998 ED73 was gazetted by the Australian Accounting Standards Board and became AASB 1038. There were some changes made to ED73 in producing the final standard.

A summary of the main disclosure requirements of the standard is set out below. However, in a late change to the standard the AASB removed a section dealing with transfers of blocks of business.

- life insurers must prepare a general purpose financial report which complies with AASB accounting standards;
- the financial statements must include all assets, liabilities, revenues and expenses, whether they are designated to shareholders or policyholders. Therefore:
  - a life insurer’s accounts will comprise total (combined) statutory and shareholder’s funds;
  - consolidated accounts will include the statutory funds of any life insurer subsidiaries.
- the excess of net market values over net assets (including any goodwill) in subsidiaries must be recognised as a separate asset;
- the components of premiums and claims must be separately recognised as revenues, expenses and movements in liabilities where practicable (and reliable). An additional two year transition period is allowed for implementing this;
- reinsurance must be treated on a gross basis by ceding insurers and accepting reinsurers;
- acquisition costs which are expected to be recovered must be measured and amortised as a function of determining policy liabilities and be disclosed as a component of policy liabilities rather than as a separate asset;
- imputed inflows and outflows which do not relate to transactions with external parties must not be recognised in the financial statements themselves (but are included for the disaggregated disclosures);
• disaggregated information must be reported for each statutory fund and the shareholder fund (showing investment-linked and non-investment linked business) as well as the usual geographic segment disclosures.

Canadian reporting

The Canadian disclosure requirements make a concerted effort to reflect the economic reality of the life insurance business, with non-financial information that augments the financial disclosures.

Further to the specific disclosure already considered under the United Kingdom and Australian requirements, the Canadian standards require significant narrative and qualitative disclosure, for example:

• the nature of actuarial liabilities (being a description of what they represent, that they include provisions for possible adverse deviation from the best estimate assumptions, and that many of the input variables are subject to revision based on actual experience);
• factors influencing measurement uncertainty, particularly how such measurement uncertainty is allowed for in the actuarial valuation process;
• causes of changes in the actuarial assumptions, rather than glib disclosure of the fact that the assumptions have changed and by what extent;
• consideration of the impact of interest rate, credit and reinsurance risk on both assets and liabilities.

It is clear that the Canadian standard-setting bodies have noted the value of non-financial information as it pertains to life insurance companies. There can be no question that, were South African insurers to include such information in their annual reports, their usefulness would be greatly enhanced. However, it is no doubt justified to point out that the South African companies should first address the shortcomings in their financial disclosure before attempting to add value to it with any sort of discursive analysis.

Local accounting developments

Some initiative is being taken by the South African Institute of Chartered Accountants towards the development of a new standard for insurance accounting in South Africa. However, this initiative is being driven by following
IASC developments (as part of the harmonisation process) rather than any specific local development.

Since it is unlikely that the IASC statement on insurance accounting will be available before 2002, and because the South African standard has not seen any development since 1994, it is important that the long-term insurance industry and the actuarial and accounting professions co-operate in the urgent revision of AC121. While cues can be taken from the IASC developments as they emerge, the standard should be specifically applicable to the peculiarities of the local industry, instead of a carbon copy of a generic international benchmark.
Chapter 6

Conclusions and recommendations

The questions

This dissertation set out to find answers to the following questions:

- What is the extent and adequacy of disclosure (as a proxy for usefulness) by South African life insurance companies when compared to local and international life insurance accounting standards?
- Was there a significant change in the extent of disclosure by life insurance companies in South Africa after the revisions to the disclosure requirements effective from 1994?
- Was there a trend of increased disclosure from 1995 to 1997?
- Have international insurance reporting standards influenced the extent of disclosure by South African life insurance companies?

The findings of the empirical and qualitative study conducted on the sample of financial reports are given below.

The extent and adequacy of reporting

When compared to the local benchmark, AC121, South African life insurance companies appear to be adequately complying with the disclosure requirements on the basis of the disclosure scores shown in Appendix E. While the actual compliance differs significantly from a 100% ideal, subjective observation reveals that the minimum level of compliance in 1997 was 78%.

However, the extent of compliance with the two international benchmarks used is inadequate, and differs significantly from the extent of compliance with the local standard. This implies that that:

- the extent of reporting by South African life insurance companies, evident from the actual disclosure scores of the sample pertaining to the international benchmarks is poor, and
• the adequacy of such reporting is insufficient, since South African life companies have not offered the level of detail in their disclosure required by the international benchmarks.

Clearly then, since the proxies for usefulness, being the extent and adequacy of reporting, are compromised, it can only be concluded that the annual financial statements of life companies in South Africa are less useful than they should be.

It must therefore be recommended that AC121 is urgently revised so as to be more in line with international requirements in terms of the level of detail and disclosure attributes required by international guidelines.

**Significant change in extent from 1993 to 1995**

The results of the tests of Hypothesis 3 indicate that there was indeed a significant change in the extent of reporting by South African life insurance companies from 1993 to 1995. However, these changes were precipitated by the introduction of AC121 and the repeal of Part V to Schedule 4 of the Companies Act.

Since the content of AC121 was by in large in the field before 1995 (in the content of AC204, which was a guideline only), it follows that the changes in the legal reporting requirements were the principal drivers of the change in the extent of disclosure.

The application of GAAP needs to be more rigorously enforced by the auditors of the respective life companies, or legal credence needs to be given to compliance with statements of GAAP in section 286(3) of the Companies Act in order to ensure that life companies provide adequate disclosure in their accounts.

**Trend of increased disclosure from 1995 to 1997**

The results of the tests of Hypotheses 3 and 4 show how the incremental disclosures provided by South African life insurance companies from 1995 to 1997 in terms of all the benchmarks used were not significant.
This can be attributed in part to the lack of development in the local standard since 1994. Given how insignificant the incremental disclosures offered by the South African life companies in terms of the international benchmarks were, it is also evident that little cognisance was being taken of developments in life insurance reporting abroad.

Given the stagnation in the development and improvement of the local standard, South African life companies should be encouraged to take their disclosure cues from international benchmarks.

The influence of international benchmarks

The significance of the difference in the extent of disclosure from 1993 to 1995 is largely explained by changes to the domestic reporting requirements.

The difference in the extent of disclosure by the sample of South African life insurers from 1995 to 1997 was found to be insignificant, an observation which is corroborated by a cursory glance at the minor instances of incremental disclosure over the same period.

There is no clear evidence of influence by the respective international benchmarks over the nature and extent of disclosure by South African life insurance companies. Those disclosures that did indeed emerge are most likely a function of the various companies' discretion than any overt attention to the requirements of international requirements.
## Appendices
### Appendix A

Extracts from the KPMG Canadian Insurance reporting survey

### INVESTMENTS Disclosure

1.6.1 Are non-performing investments (other than impaired loans) disclosed in the financial statements?

<table>
<thead>
<tr>
<th>Answer</th>
<th>% of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>28%</td>
</tr>
<tr>
<td>No</td>
<td>22%</td>
</tr>
<tr>
<td>N/A</td>
<td>50%</td>
</tr>
</tbody>
</table>

1.6.2 What categories of portfolio investments were disclosed separately?

OR, if CICA Section 3860 was applied:

What categories of portfolio investments were disclosed separately as "classes" of financial assets on the balance sheet? (please circle your choices)

<table>
<thead>
<tr>
<th>Category</th>
<th># of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash and short term deposits</td>
<td>31</td>
</tr>
<tr>
<td>Bonds - in total only</td>
<td>26</td>
</tr>
<tr>
<td>Bonds - corporate, federal government, provincial government</td>
<td>5</td>
</tr>
<tr>
<td>Mortgages - in total only</td>
<td>18</td>
</tr>
<tr>
<td>Mortgages - residential, commercial</td>
<td>7</td>
</tr>
<tr>
<td>Interest bearing securities - in total only</td>
<td>0</td>
</tr>
<tr>
<td>Stocks - in total only</td>
<td>20</td>
</tr>
<tr>
<td>Stocks - common, preferred</td>
<td>4</td>
</tr>
<tr>
<td>Real estate</td>
<td>21</td>
</tr>
<tr>
<td>Foreclosed property</td>
<td>6</td>
</tr>
<tr>
<td>Other</td>
<td>13</td>
</tr>
</tbody>
</table>

8 respondents provided further details on the "Other" category. 4 respondents indicated they separately disclosed loans on the financial statements including policyholder loans, commercial loans and corporate loans. Investments in segregated funds (other money) were disclosed in the financial statements by 2 companies. One respondent disclosed stocks in terms of Canadian and foreign while one respondent included bonds, mortgage pools and stocks within marketable securities.
1.6.3 Did you apply the recommendations of CICA Section 3860 in 1996?

Yes - fully applied 13%
No 60%
Yes - partially applied 27%

2 respondents indicated that they disclosed the interest rate risk.

In questions 1.6.4 to 1.6.12 the percentages are based on the number of respondents who answered "yes - fully applied" or "yes - partially applied" to question 1.6.3

1.6.4 Did you disclose fair values separately from market values?

Yes 19%
No 81%

1.6.5 Were fair values determined to approximate market values?

Yes 100%
No 0%

1.6.6 Did you have any significant investment(s) for which a fair value(s) could not be determined?

Yes 6%
No 94%

1.6.7 Did your investment portfolio include items that required disclosure of significant terms and conditions affecting the amount, timing and certainty of future cash flows (for example, foreign currency risks and market risks)?

Yes 0%
No 100%
1.6.8 Did you disclose interest rate risk (including maturity dates, contractual repricing and effective interest rates) for the same "classes" of investment as described in Question 1.25, or did you use a different classification approach?

Same classes as balance sheet 50%
Different classes 7%
Did not respond 43%

1.6.9 How did you disclose the values and effective interest rates of investments subject to interest rate risk?

For Effective Interest Rates:
Ranges 21%
Overall average 21%
Did not respond 58%

For Maturity Dates/Contractual Repricing Dates:
Ranges 21%
Overall average 24%
Did not respond 65%

1.6.10 Did you disclose interest rate risk through use of sensitivity analysis (for example, the hypothetical change in prevailing level of market interest rates on the fair value of the investment, future earnings and cash flows)?

Yes 21%
No 79%

1.6.11 Did your investment portfolio include items that required disclosure of the maximum credit risk exposure (CICA Section 3860.67)?

Yes 14%
No 86%
1.6.12 Did you disclose any significant concentrations of credit risk?

Yes 13%
No 47%
N/A 40%

ACTUARIAL AND OTHER LIABILITIES
Disclosure

2.1.1 What categories of actuarial liabilities were disclosed?

# of respondents

<table>
<thead>
<tr>
<th>Category</th>
<th># of respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annuities</td>
<td>20</td>
</tr>
<tr>
<td>Life insurance - in total only</td>
<td>5</td>
</tr>
<tr>
<td>Life insurance - individual</td>
<td>14</td>
</tr>
<tr>
<td>Life insurance - participating and non-participating</td>
<td>12</td>
</tr>
<tr>
<td>Life insurance - group</td>
<td>9</td>
</tr>
<tr>
<td>Health insurance</td>
<td>16</td>
</tr>
<tr>
<td>Total only</td>
<td>8</td>
</tr>
<tr>
<td>Other</td>
<td>5</td>
</tr>
</tbody>
</table>

3 respondents provided further details on the "Other" category. One company disclosed the reinsurance ceded amount. Another company disclosed the group life and health actuarial liabilities. One respondent replied that the company disclosed the actuarial liabilities of group life and health policies, U.S. policies, and savings and retirement policies.
2.1.2 How was the extent of measurement uncertainty disclosed?

<table>
<thead>
<tr>
<th># of respondents</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>Quantification through sensitivity analysis regarding a change in a key assumption by a specified amount</td>
</tr>
<tr>
<td>7</td>
<td>Quantification through disclosure of the amounts of the provisions for adverse deviation</td>
</tr>
<tr>
<td>1</td>
<td>Quantification through disclosure of experience gains/losses</td>
</tr>
<tr>
<td>1</td>
<td>Disclosure of a range of the possible actuarial liability</td>
</tr>
<tr>
<td>3</td>
<td>It was considered that there was no material measurement uncertainty associated with the actuarial liability and therefore no disclosure was made</td>
</tr>
<tr>
<td>14</td>
<td>Minimal disclosure that &quot;it is reasonably possible, based on existing knowledge, that changes in future conditions in the near term could require a material change in the recognized amount&quot;</td>
</tr>
<tr>
<td>4</td>
<td>Other</td>
</tr>
</tbody>
</table>

8 respondents provided further information in the disclosure policy. Other information disclosed included a statement that the PADS were within the range prescribed by the CIA; key assumptions or factors in determining the amount of policy liabilities; and the nature of the policy liabilities. One respondent indicated that no disclosure was made in 1996.

2.1.3 For the first 2 answers Question 2.1.2 above, was the information given on a line of business basis?

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>6%</td>
</tr>
<tr>
<td>No</td>
<td>42%</td>
</tr>
<tr>
<td>N/A</td>
<td>52%</td>
</tr>
</tbody>
</table>
For either the first 2 answers in Question 2.1.2 above, was the information given on a geographic basis?

Yes 0%
No 45%
N/A 55%

2.1.4 Where was measurement uncertainty disclosed?

Accounting policy note 19%
Separate note on actuarial liabilities 48%
Combination of the above 2 responses 13%
No material measurement uncertainty considered associated with actuarial liabilities and therefore no disclosure. 20%

2.1.5 Did you apply the recommendations of AcG-8 - Actuarial Liabilities of Life Insurance enterprises - Disclosure:

<table>
<thead>
<tr>
<th># of respondents</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td>Composition of actuarial liabilities and related assets</td>
<td>13</td>
<td>19</td>
</tr>
<tr>
<td>Nature of actuarial liabilities</td>
<td>22</td>
<td>10</td>
</tr>
<tr>
<td>Measurement uncertainty</td>
<td>18</td>
<td>14</td>
</tr>
<tr>
<td>Changes in actuarial liabilities</td>
<td>17</td>
<td>15</td>
</tr>
<tr>
<td>Interest rate risk</td>
<td>13</td>
<td>19</td>
</tr>
<tr>
<td>Credit risk</td>
<td>11</td>
<td>21</td>
</tr>
<tr>
<td>Reinsurance risk</td>
<td>10</td>
<td>22</td>
</tr>
<tr>
<td>Other risks</td>
<td>9</td>
<td>23</td>
</tr>
<tr>
<td>Fair value of financial assets and liabilities</td>
<td>6</td>
<td>26</td>
</tr>
</tbody>
</table>

If no, do you intend to apply the recommendations in 1997?

Yes 62%
No 0%
Undecided 38%
2.1.6 Do the financial statements disclose the effect of changes in actuarial assumptions versus the effect of changes in methodology?

Changes in actuarial assumptions 32%
Changes in methodology 3%
Both disclosed together 26%
No disclosure made 36%
N/A 3%

2.1.7 Did you disclose the amount of provisions for adverse deviations separately in the financial statements?

Yes 22%
No 78%

If yes, how was disclosure made

In total only? 86%
By category of PAD? 0%
By category of disclosure of actuarial liability? 0%
Other 14%

One respondent indicated that the PAD was disclosed for asset defaults and lapses only.

2.1.8 Are the asset default provisions included within actuarial liabilities disclosed?

Yes 50%
No 41%
N/A 9%
2.1.9 Was the fair value of actuarial liabilities omitted from the financial statements as it was not practicable to determine?

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>39%</td>
</tr>
<tr>
<td>No</td>
<td>3%</td>
</tr>
<tr>
<td>Did not apply CICA Section 3860</td>
<td>58%</td>
</tr>
</tbody>
</table>

2.1.10 Did you disclose the effective interest rate used in discounting actuarial liabilities?

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>0%</td>
</tr>
<tr>
<td>No</td>
<td>100%</td>
</tr>
</tbody>
</table>

REINSURANCE
Disclosure

3.2.1 How is reinsurance ceded by the Company disclosed in the financial statements?

<table>
<thead>
<tr>
<th>Description</th>
<th># of respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Described in accounting policy notes</td>
<td>16</td>
</tr>
<tr>
<td>Note disclosure of reinsurance practices including such information as maximum retention</td>
<td>14</td>
</tr>
<tr>
<td>Dollar amounts of premiums, benefits, commissions and actuarial liabilities ceded disclosed</td>
<td>16</td>
</tr>
<tr>
<td>Dollars ceded shown directly on income statement or balance sheet</td>
<td>1</td>
</tr>
<tr>
<td>No mention in financial statements</td>
<td>5</td>
</tr>
<tr>
<td>Other</td>
<td>6</td>
</tr>
</tbody>
</table>

5 respondents provided further information. 3 respondents stated that they disclosed the dollar amount of the actuarial liabilities ceded. One company only disclosed the premiums and liabilities amounts. Another respondent indicated that they disclosed the general concept of reinsurance ceded in a contingent liability note.
3.2.2. Did you disclose a maximum credit risk exposure associated with reinsurance recoverable balances?

Yes 3%
No 69%
N/A 9%
Did not apply CICA Section 3860 19%

3.2.3 Did you disclose any significant concentrations of credit risk?

Yes 6%
No 56%
N/A 16%
Did not apply CICA Section 3860 22%

One respondent disclosed that the reinsurance ceded was primarily with one reinsurer.

FINANCIAL STATEMENT PRESENTATION AND DISCLOSURE

General

5.1.1 Do you provide a general description of the nature of the business of the Company?

Yes 75%
No 25%
5.1.2 Did you apply the recommendations of AcG-9 - Financial Reporting by Life Insurance Enterprises:

<table>
<thead>
<tr>
<th>Recommendation</th>
<th># of respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquisition costs</td>
<td>14 18</td>
</tr>
<tr>
<td>Administrative expenses</td>
<td>13 19</td>
</tr>
<tr>
<td>Impaired assets</td>
<td>12 20</td>
</tr>
<tr>
<td>Provision for credit losses in actuarial liabilities</td>
<td>13 19</td>
</tr>
<tr>
<td>Net disinvestment of a portfolio</td>
<td>6 26</td>
</tr>
<tr>
<td>Policyholder dividends</td>
<td>14 18</td>
</tr>
<tr>
<td>Income on participating policies</td>
<td>11 21</td>
</tr>
<tr>
<td>Corporate income taxes</td>
<td>7 25</td>
</tr>
<tr>
<td>Capital taxes</td>
<td>13 19</td>
</tr>
<tr>
<td>Capital and surplus</td>
<td>13 19</td>
</tr>
</tbody>
</table>

If yes, did the application of AcG-9 result in a change in accounting practices for your Company?

- Yes 12%
- No 88%

If no, will the application of AcG-9 result in a change in accounting practices for your Company?

- Yes 33%
- No 67%

5.1.3 Did the Company disclose earnings performance by line of business?

- Yes 28%
- No 72%

5.1.4 If your Company has a deposit-taking institution as a subsidiary, how was premium income on deposit-type instruments disclosed in the consolidated financial statements?

- Premium income 0%
- Liability 6%
- N/A 94%
- Solvency
5.2.1 Do your financial statements disclose Minimum Continuing Capital and Surplus Requirement (MCCSR)?

<table>
<thead>
<tr>
<th></th>
<th># of respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Concept of MCCSR is disclosed</td>
<td>9</td>
</tr>
<tr>
<td>The Company's MCCSR percentage is disclosed</td>
<td>4</td>
</tr>
<tr>
<td>The Company's compliance with MCCSR is disclosed</td>
<td>14</td>
</tr>
<tr>
<td>No disclosure is made of MCCSR</td>
<td>16</td>
</tr>
</tbody>
</table>

**Segregated Funds**

5.3.1 How were the financial statements of segregated accounts shown separately from those of the general account?

- Shown on separate pages: 65%
- Balance sheet or income statement shown together on the same page, but not added together: 3%
- Statements shown on same page, and total provided: 29%
- N/A: 3%

5.3.2 How do you account for transfers to and from Segregated Funds (please describe):

In the year of policy issue:

7 respondents provided information as to the accounting of transfers to and from segregated Funds.

One respondent indicated that the transfer amounts are recorded as either contributions or withdrawals.

Another respondent stated that all transfers are netted in premiums.

One company accounted for the transfer at market value.

One respondent replied that the transfer amounts were recorded in the general fund annuity benefit account (for transfers to) in the general fund annuity premiums account (for transfers from).

One indicated that the reserve is transferred at the time when a client requests such a transfer.
Another respondent stated that all premiums were posted to a suspense account first and the portion relating to the segregated fund would then be transferred to the segregated fund premium account.

One replied that the transfers were made where a policy has an amount on deposit either from dividends not taken or an investment deposit. Therefore, the transfers would be accounted for as a policy liability and may be withdrawn from the general fund and transferred to a segmented fund investment or vice-versa.

In subsequent years:

5 respondents provided information as to the accounting transfer of segregated funds in subsequent years.

4 indicated that there is no difference in accounting treatment between the year when the policy is issued and in subsequent years.

1 respondent replied that in subsequent years, transfer-in amounts are netted in premiums whereas transfer-out amounts are debited against disbursements.

**Participating Policyholders**

5.4.1 Are participating policyholder dividends shown as an expense in determining net income, or as a distribution from participating account surplus?

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Expense</td>
<td>75%</td>
</tr>
<tr>
<td>Surplus distribution</td>
<td>3%</td>
</tr>
<tr>
<td>N/A</td>
<td>22%</td>
</tr>
</tbody>
</table>
5.4.2 Do the financial statements disclose the amounts of operating income derived from participating business and non-participating business?

Yes 41%
No 34%
N/A 25%

5.4.3 If you are a stock Company with participating policyholders, do the financial statements disclose the portion of the par account allocated to shareholders, but not yet transferred to the shareholders' account?

Yes 19%
No 28%
N/A 53%

Segmented Reporting

5.5.1 What best describes your Company's business segments disclosures?

"One industry" (i.e., all in one segment) 53%
Multiple segments: Separate segment(s) for foreign business 0%
Significant product lines (e.g., individual, group) 26%
Separate segment(s) for geographic location 12%
Protection (insurance) products vs. savings products 9%
Trust/banking operations 0%

Responsibility Statements

5.6.1 Do your financial statements contain descriptions of the roles of the actuary and the auditor?

Yes 84%
No 16%
5.6.2 Do your financial statements contain a Management Statement of Responsibility for the Financial Reporting?

Yes 72%
No 28%

Related Party Transactions

5.7.1 Did you record any related party transactions at the carrying amount?

Yes 34%
No 38%
N/A 28%

If yes, was a debit/credit carried to contributed surplus?

Yes 27%
No 73%

One respondent indicated that related party transactions include home office charges, and another respondent indicated that related party transactions included management fees paid to the parent company.

5.7.2 Did you disclose the role of the Conduct Review Committee?

Yes 33%
No 67%

Financial Instruments

5.8.1 Did you disclose fair value information relating to your financial assets and financial liabilities:

In one note 19%
Throughout various notes to the financial statements 19%
Did not apply CICA Section 3860 62%

5.8.2 Did you disclose the existence of any off-balance sheet financial instruments?
Yes 28%
N/A? - none existed/not material 66%
Did not apply CICA Section 3860 6%

5 respondents provided further details. 2 companies disclosed interest rate and foreign exchange swaps.

The notional amounts of futures and call options were disclosed by 1 company. Another company disclosed the derivative instruments used in hedging and assets/liability management. One company disclosed derivatives as a note to the financial statements.

Pensions/Other Post-Employment Retirement Benefits

5.9.1 Do you have a Company pension plan?

Yes 88%
No 12%

If yes, did you disclose significant terms and conditions relating to the pension obligation in the financial statements?

Yes 50%
No 36%
N/A 4%
Did not apply CICA/Section 3860 10%

If yes, did you disclose the fair value of the pension assets and pension obligation?

Yes 67%
No 21%
N/A 12%
5.9.2 Do you provide post-employment benefits other than pensions?

Yes 72%
No 19%
N/A 9%

If yes, how are these accounted for?

Pay-as-you-go 63%
Current accrual method whereby a current service cost is actuarially determined and accrued 25%
An estimated liability for benefits is accrued at the time the employee retires 12%

If yes, do you disclose an accounting policy?

Yes 17%
No 83%

If yes, do you disclose

The post-employment retirement benefit paid during the year 0%
The post-employment retirement benefit expense 9%
The post-employment retirement benefit obligation 9%

ANNUAL REPORTS

6.1 Does your Company prepare an annual report for external distributions?

<table>
<thead>
<tr>
<th># of respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
</tr>
<tr>
<td>No</td>
</tr>
<tr>
<td>N/A</td>
</tr>
</tbody>
</table>
If yes, does it include:

<table>
<thead>
<tr>
<th>Description</th>
<th># of respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management Discussion and Analysis</td>
<td>14</td>
</tr>
<tr>
<td>Other financial analysis or expansion of financial statement disclosure</td>
<td>13</td>
</tr>
<tr>
<td>A message from the Chief Executive Officer or other members of management of the Company's operations</td>
<td>22</td>
</tr>
<tr>
<td>Management's Statement of Responsibility for the financial statement information presented?</td>
<td>21</td>
</tr>
</tbody>
</table>

Is it sent to policyholders?

<table>
<thead>
<tr>
<th>Response</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>20%</td>
</tr>
<tr>
<td>No</td>
<td>8%</td>
</tr>
<tr>
<td>If requested</td>
<td>72%</td>
</tr>
</tbody>
</table>
Appendix B

Canadian disclosure checklist

Composition of actuarial liabilities and related assets

Disclose by
a) major line of business
b) major geographical area
c) types of investments supporting each line of business
d) capital and surplus for each line of business

Distinguish between participating and non-participating insurance where material

Nature of actuarial liabilities

Nature of actuarial liabilities should be disclosed including:

a) that actuarial liabilities represent amount which, together with estimated future premiums and investment income, will be sufficient to pay estimated future benefits, including policyholder dividends, and expenses
b) the actuarial liabilities include additional amounts to provide for possible adverse deviation from best estimate assumptions and those amounts vary based on the degree of uncertainty in the assumptions
c) many of the estimates used in the actuarial valuation relate to events that may occur many years in the future and are subject to revision at subsequent measurement dates

Measurement uncertainty

Information disclosed concerning the nature of measurement uncertainty would describe in general terms:

a) the major factors (e.g. future policy claims and benefits, future dividends, future investment yields, future taxes etc) taken into account in the computation of actuarial liabilities and the major assumptions relative to those factors
b) the major sources of data used in the computation of actuarial liabilities
c) how measurement uncertainty is allowed for in the actuarial valuation process, including the establishment of margins for adverse deviation

Information on the extent of measurement uncertainty when it is reasonably possible that that a change in assumptions could cause a recognised amount to change by a material amount in the near term, including:

Description of extent of measurement uncertainty should reflect product profile and individual circumstances of the enterprise. Include:

a) the extent to which actuarial liabilities would change if a key assumption changed by a specified amount
b) disclose the extent to which actual experience on certain factors has varied from actuarial assumptions OR
c) disclose the relationship between current actuarial assumptions and recent experience

Disclose:

a) the total amount of the provision for adverse deviation
b) explanation of the nature of the risks allowed for in that provision
c) company's overall approach to providing for possible adverse experience
d) level of conservatism incorporated into both the assumptions for expected experience and the associated margins for adverse deviation.

AcG-8 24 Disclosure by major cause:
   a) changes in actuarial assumptions
   b) changes in the provision for adverse deviation
   c) explanations for each material change

AcG 8 25 Changes in actuarial liabilities should distinguish between:
   a) changes caused by normal business activities
   b) unusual events
   c) changes in assumptions
   d) material changes in assumptions that offset each other should be disclosed separately.

AcG-8 26 Interest rate risk: disclose information on the impact of changes in interest rates on the valuation of financial assets and financial liabilities including:
   a) extent of exposure to reinvestment risk and how provision has been made for that exposure.

AcG-8 27 Credit risk: disclose the extent to which expected future investment yields have been reduced by:
   a) provisions for credit losses
   b) and the amount of any additional provisions for cyclical credit losses included in the computation of actuarial liabilities.

AcG-8 28 Reinsurance risk:
   a) Disclose the extent to which actuarial liabilities have been reduced as a result of future claims expected to be recovered under reinsurance-ceded arrangements.
   b) Amounts recoverable from reinsurers for claims already incurred should be presented as reinsurance claims receivable on the balance sheet.

AcG-8 29 a) Identify amounts of significant concentrations of reinsurance coverage with one reinsurer or group of reinsurers.
   b) A note containing a statement that reinsurance transactions do not relieve the insurer of its primary obligations to policyholders
   c) Disclose the enterprise's retention policy and limits

AcG-8 31 Other risks:
   Nature and extent of other risks such as:
   a) liquidity risk
   b) foreign exchange risk

AcG-8 32 Fair value of financial assets and liabilities
   a) Disclose the fair value of invested assets

AcG-8 34 b) Disclose the fair value of liabilities

AcG-8 35 If determining the fair value of actuarial liabilities with sufficient reliability is not considered to be practicable, the note to the financial statements should:
   a) identify separately the fair values and carrying values of assets backing actuarial liabilities
   b) the portion of deferred realised gains and losses taken into account in the computation of actuarial liabilities.
   c) where cash flows on invested assets and actuarial liabilities are effectively matched, the notes should indicate that changes in the fair value of these assets are offset by changes in the fair value of actuarial liabilities.

A review of disclosure in the annual financial reports of life insurance companies in South Africa: 1999
d) where cash flows are not effectively matched, the extent to which differences between the fair values and carrying values of financial assets would not be taken into account in the valuation of actuarial liabilities should be estimated and disclosed.

AcG-8 36 When the fair value of actuarial liabilities has been disclosed, disclose:
a) the basis upon which the fair value has been determined
b) disclose values at which related items, such as deferred gains and losses and deferred income taxes, would be stated if financial assets and liabilities were measured at fair values.

AcG-9 21 Policyholder dividends that are unusually large and not expected to occur regularly over several years should be disclosed separately

AcG-9 33 In addition to any other restrictions that may exist on the distribution of retained earnings, life insurance enterprises should disclose in the notes:
a) the nature of restrictions on the distribution of retained earnings or surplus imposed by government regulation.
b) the existence of any condition where failure to meet minimum regulatory standards may constrain the enterprise's ability to pay dividends or accept new business.

Section 4210.22 The following information should be disclosed with respect to portfolio investments held by life insurance enterprises:
a) description of the accounting policy regarding portfolio investments, including the rate used in applying the moving average market method
b) the aggregate carrying value and market value of the investments, divided among investments carried at
- moving average market
- amortised cost
c) for each of the components in (b):
- investment revenue.
- gains included in income
- losses included in income
d) the balance of any deferred realised gains and losses on portfolio investments to be recognised in income in future periods.
e) the amount of any write-down in the current period resulting from other than temporary declines in the value of an entire portfolio.
f) if appraisals are used to establish carrying values, those carrying values and the basis of appraisal should be disclosed separately

Section 4210.23 Subdivide the information on portfolio investments disclosed by type of investment

Section 4210.36 The financial statements of the segregated account business [managed funds] of life insurance enterprises should be presented separately from the financial statements of the general account business.

Section 4210.39 Portfolio investments held in segregated accounts should be carried in the segregated account balance at their market value as at the balance sheet date.

Section 4210.40 Gains and losses on portfolio investments held in segregated accounts, which arise on adjustment of the carrying values of the investments to reflect their current market values, should be included in the segregated account income in the current period.
Section 4210.47 Participating policyholder interest should be shown separately from shareholders' equity

Section 4210.48 The following disclosures should be made by a stock life insurance company:
   a) the portion of operating income and net income derived from participating business
   b) the portion of operating income and net income derived from non-participating business
   c) the portion of the participating account which has been allocated to shareholders, but not yet distributed by way of declared dividends
   d) the portion of the participating account which has been allocated to policyholders, but not yet distributed by way of a transfer to the non-participating account.

Section 4210.49 The following disclosures should be made by a mutual life insurance company:
   a) the portion of operating income derived from participating business
   b) the portion of operating income derived from non-participating business
## Appendix C

### Sample of companies

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<tr>
<th>Company</th>
<th>Year-end</th>
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Appendix D

Disclosure checklists

South Africa

General
AC121.24 Do the financial statements disclose the accounting policies applied to material items in the financial statements?
AC121.38 Has the fact that the insurer manages assets on behalf of other parties been disclosed together with the fair value of those managed assets?
AC121.13 Do the financial statements include:
   a) directors' report
   b) balance sheet
   c) income or operating statement
   d) statement of cash flow information
   e) notes to the financial statements
   f) auditor's report
   g) actuary's report

Actuary's report
AC121.21 Does the report prepared by the actuary include a statement of the actuarial values of assets and liabilities?
AC121.21 Is the actuary's report in accordance with the guidelines issued by the Actuarial Society of South Africa, which includes, in addition to the requirement above, unless included in the financial statements:

Life Fund
AC121.14 Do the details of the movement in the life fund distinguish between:
   a) Transfers to or from the income or operating statement?
   b) The aggregate gains or losses on revaluation and on disposal of investments?
   c) All other material movements?

Investments
AC121.15 Have the investments been disclosed as a separate item, analysed into major investment categories?
AC121.15 Has a segmental analysis of the total equity investment been disclosed?

Income or Operating statement
AC121.25 Have the major components of investment income, such as interest, dividends, net rentals and other income been disclosed?
AC121.26 Has premium income (net of reinsurance) from policyholders been grouped and disclosed into appropriate categories:
   a) Individual single premiums
   b) Individual recurring premiums
   c) Group lump sums
   d) Group other
AC121.26 Where material, have reinsurance premiums been separately disclosed?
AC121.27 Have policyholders' benefits (net of reinsurance) been grouped and disclosed into appropriate categories separately identifying individual and group policies

A review of disclosure in the annual financial reports of life insurance companies in South Africa: 1999
a) death and disability claims
b) maturity claims
c) Annuity payments
d) Individual policy surrenders
e) Group member withdrawal payments
f) Group scheme terminations

AC121.27 Where material, have reinsurance benefits been separately disclosed?
AC121.33 Have operating/management expenses been disclosed in total, excluding sales remuneration?
AC121.33 Has sales remuneration been separately disclosed?
AC121.36 Have the following been disclosed:
   a) aggregate directors emoluments?
   b) auditors remuneration distinguishing between the fee for the audit, other services and expenses?

AC121.35 {OPTIONAL} Disclosure of the tax charge relating to
   a) individual policyholder fund
   b) company policyholder fund
   c) corporate fund
United Kingdom

Technical account

1Sch.7(3) Earned premiums, net of reinsurance
   a) Gross premiums written
   b) Outward reinsurance premiums
1Sch.2(3) Investment income
   Unrealised gains on investments [may also be shown in a "revaluation reserve"]
1Sch.7(3) Claims incurred, net of reinsurance
   a) Claims paid
      - gross amount
      - reinsurer's share
   b) Change in the provision for claims outstanding
      - gross amount
      - reinsurer's share
1Sch.7(3) Changes in the Long term business provision, net of reinsurance
      - gross amount
      - reinsurer's share
1Sch.7(4) Changes in Provisions for linked liabilities
1Sch.2(3) Bonuses and rebates, net of reinsurance
1Sch.2(3) Net operating expenses
1Sch.2(3) Investment expenses and charges
1Sch.2(3) Tax attributable to the long term business
1Sch.2(3) Transfers to the fund for future appropriations

Non-technical account

ABI.176 Tax attributable to shareholders' profit
1Sch.2(3) Investment income
1Sch.2(3) Unrealised gains on investments [may also be shown in a "revaluation reserve"]
1Sch.2(3) Investment expenses and charges

Assets

1Sch. Part 1

Other financial investments
Assets held to cover linked liabilities
Reinsurers' share of technical provisions
Long term business provision
Claims outstanding
Technical provisions for unit linked liabilities
Debtors
Debtors arising out of direct insurance operations
- policyholders
- intermediaries
Deferred acquisition costs

1Sch.11 Include managed funds in the company's balance sheet
Note disclosing total amount included with respect to such assets and liabilities, detailing amount included under each relevant balance sheet heading or sub-heading.
Liabilities
Fund for future appropriations
Technical provisions
Long term business provision
Claims outstanding
Technical provisions for linked liabilities

Notes
Accounting policies relating to:
Premiums
Claims
Bonuses
Investments

1Sch.28(2)
- investment valuations
- investment income and expenses
- investment gains

Long term business provision

ABI,155 Valuation method
ABI,159 Implicit or explicit provision for reversionary bonuses
Allocation of surpluses and fund for future appropriations
ABI,168 Basis of determination of appropriation of surplus from technical account
ABI,174 Gross up of transfer to shareholder's profit from technical account by attributable tax.
ABI,165 Basis upon which fund has been established
Deferred acquisition costs

1Sch.BS(17) Basis of determination
ABI,153 Basis of rate of amortisation

1Sch.77(1), Segmental analysis differentiating between:
1Sch.76(2) (b) (i)-
(iii)

a) Gross premiums written
Recurring and single premiums
Non-participating business
- life
- annuity
- permanent health
Participating business
- pensions
- life
Linked business
- pensions
- life

1Sch.76(2) (b)(i) Total to be segmented between group and individual business
ABI,181 b) Gross new business premiums
Recurring and single premiums
Non-participating business
- life
- annuity
- permanent health
Participating business
- pensions
- life
Linked business
- pensions
- life
Total to be segmented between group and individual business

ABI,181 Basis of new business recognition
ABI,177; Reinsurance payable in respect of long term business
1Sch.76(1) (b)

Investment return summary
Long term insurance business
1Sch.Part1
Investment income
Income from land and buildings
1Sch.73(4)
Income from listed investments
1Sch.73(4)
Income from other investments
1Sch.73(4)
Gains on the realisation of investments
1Sch.Part1
Detail on investment expenses and charges
Unrealised gains on investments
Net investment return included in the long-term business technical account

Shareholder’s interest
1Sch.Part1
Investment income
Income from land and buildings
1Sch.73(4)
Income from listed investments
1Sch.73(4)
Income from other investments
1Sch.73(4)
Gains on the realisation of investments
1Sch.Part1
Detail on investment expenses and charges
Unrealised gains on investments
Net investment return included in the non-technical account

Total investment return

Movement in prior year’s provision for claims outstanding
Net opening balance of provision
Net claims paid in respect of provision
Net outstanding claims carried forward from prior year
(Under)/over provision in respect of prior year provision

1Sch.P&L(4) Analysed by type of benefit
Death claims
Surrender

Net operating costs
Acquisition costs
Change in deferred acquisition costs
Administrative expenses
Reinsurance commissions and profit participation

1Sch.78
Commissions paid

Investments (at current value)

1Sch.28(3)
a) Shares and other variable yield securities and units in unit trusts
b) Debt securities and other fixed income securities
c) Deposits with credit institutions
d) Other investments

For a) and b) above, the following segmental reporting:
Those listed on a recognised investment exchange
Other listed investments
Total listed investments

1Sch.28(3)
Assets held to cover linked liabilities
At current value
At cost

Policyholder liabilities and fund for future appropriations
Segmented as follows:
Long term business provision
Claims outstanding
Technical provision for linked liabilities
Fund for future appropriations

Further segmented on a line-item basis as follows:
Opening balance
Movement in technical provisions for the year
Transfer to fund for future appropriations
Closing balance

Long term business provision
Calculated by actuary

1Sch.46(2)
Principal assumptions:
Mortality
Interest rates

ABI.157
Above to be segmented between the following classes of business
Life
- participating
- non-participating Pensions
- participating
- non-participating
Annuities

Changes in bases or assumptions since previous year
Basis of determination of deferred tax relating to long term business provisions

1Sch.P&L(5) Amount charged for bonuses and rebates
The financial report of a life insurer should include:

- statement of financial performance
- disclosure of movements in equity in a note or in the statement of financial performance
- statement of financial position
- statement of cash flows

The financial report must include a brief description of the tax regime applying to the life insurer and disclose the basis on which carrying amounts of deferred tax assets and liabilities have been determined.

**Financial performance disclosures**

- premium revenue
- investment revenue, showing revenue from:
  - equity securities
  - debt securities
  - properties
  - other
- outwards reinsurance expense
- operating expenses, showing:
  - claims expense relating to death and disability risk exposures
  - policy acquisition expenses
  - policy maintenance expenses
  - investment management expenses
  - other
- that part of the change in policy liabilities that relates to policy obligations other than those arising from the inflow or outflow of components of premiums akin to deposits
- investment revenues paid or allocated to policyholders, including the current year allocation of participating policyholder benefits

**Financial position disclosures**

**Assets:** The following must be disclosed in the broad order of their liquidity

- investments, showing:
  - equity securities
  - debt securities
  - properties
  - other by major class, where applicable
- operating assets
- reinsurance recoveries receivable

**Liabilities:** Policy liabilities and other liabilities, by nature, must be disclosed in the broad order of their liquidity. The following components of policy liabilities must also be shown:

- future policy benefits
- future bonuses
- future expenses
- future planned margins of revenue over expenses

A review of disclosure in the annual financial reports of life insurance companies in South Africa: 1999
e) future charges for acquisition costs
f) balance of future premiums

ED73 17.3  **Equity**
Retained profits wholly attributable to shareholders and any other retained profits must be separately disclosed

ED73 17.4  **Restrictions on assets**
The restrictions attaching to assets held for the benefit of policyholders must be disclosed

ED73 17.5  **Guaranteed or assured returns of funds invested**
The amount of policy liabilities which related to guaranteed or assured returns of funds invested must be disclosed

ED73 17.6  **Solvency information**
The amount of equity retained as solvency reserves and the basis of establishing the amount must be disclosed

ED73 17.7  **Managed funds and other fiduciary activities**
A life insurer must disclose the nature and amount of its involvement in managed funds and trust activities and whether arrangements exist to ensure that such activities are managed independently from its other activities

ED73 18  **Actuarial information**
ED73 18.1  The following must be disclosed in the notes to the financial statements:

a) the effective date of the actuarial report on policy liabilities and solvency reserves
b) the name and qualifications of the actuary
c) whether the amount of policy liabilities has been determined in accordance with the methods and assumptions disclosed in the financial report and with the standards of the [Actuarial Society of South Africa]
d) whether the actuary is satisfied as to the accuracy of the data from which the amount in c) has been determined

ED73 18.2  **Disclosure of assumptions**
A summary of the key assumptions used in determining policy liabilities must be disclosed in the notes to the financial statements, including:
a) discount rates, asset mix, and inflation rates
b) rates of commission
c) profit carriers used for each major product group
d) future maintenance and investment expenses, the rate of inflation applicable to them and any automatic indexation benefits and premiums
e) rates of taxation
f) mortality and morbidity, by reference to the identity of the tables
g) rates of discontinuance
h) rates of growth of the unit prices in respect of unit-linked benefits
i) the basis of allocating future participating benefits
j) rate of future supportable participating benefits
k) the crediting philosophy adopted in determining future supportable participating benefits and how it compares with the life insurer’s actual practice

**Investment linked and non-investment linked business**

ED73 19.3  Information required by paragraph 19.1 must be disaggregated as between those amounts relating to investment linked business and those relating to non-investment linked business
## Appendix E

### Aggregate disclosure scores

#### South Africa

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#### United Kingdom

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#### Australia

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Appendix F

United Kingdom incremental disclosure

1993 to 1995

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<th>Disclosure required</th>
<th>Total incidence of incremental disclosure</th>
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<td>1Sch.7(3)</td>
<td>a) Gross premiums written</td>
<td>1 Metropolitan</td>
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<td>b) Outward reinsurance premiums</td>
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<td>Unrealised gains on investments [may also be shown in a &quot;revaluation reserve&quot;]</td>
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<td>a) Claims paid - gross amount - reinsurer's share</td>
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<td>1Sch.11</td>
<td>Include managed funds in the company's balance sheet [show as footnote] Liability Fund for future appropriations</td>
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A review of disclosure in the annual financial reports of life insurance companies in South Africa: 1999
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<th>Allocation of surpluses and fund for future appropriations</th>
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<td>1Sch.2(3)</td>
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<td>Claims incurred, net of reinsurance a) Claims paid</td>
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A review of disclosure in the annual financial reports of life insurance companies in South Africa:1999
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## Appendix G

### ANOVA output

Anova: Two-Factor With Replication

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### ANOVA

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A review of disclosure in the annual financial reports of life insurance companies in South Africa: 1999
### Scheffe's method of multiple comparisons

\[(r-1) \quad 4\]

\[F \quad 5\% \quad 2.428166113\]

\[\text{Sigma} \quad 2.082840053\]

\[\text{Critical range} \quad 6.491201837\]

#### Years

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#### Benchmarks

\[(r-1) \quad 2\]

\[F \quad 5\% \quad 3.051823683\]

\[\text{Sigma} \quad 5.350912982\]

\[\text{Critical range} \quad 13.21973062\]

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SA = South Africa
UK = United Kingdom
OZ = Australia
Anova: Two-Factor Without Replication: local standard compliance

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Appendix H

South African actuarial disclosure requirements

The actuarial report should include at least the following unless shown in the rest of the financial statements:

1. Statement reflecting:
   - actuarial values of assets and liabilities [also AC121.21]
   - Free reserves
   - prudent best-estimate liabilities should be published (i.e. best-estimate valuation plus prescribed and second-tier margins)

2. Total amount of capital adequacy requirements, and a brief description of their nature [PGN103 Annexure A 9]

3. Description of valuation basis and methods according to which different broad categories of liabilities were valued:
   - Assumptions used in valuation (mortality, morbidity, expenses), and how these compare with actual experience
   - Effects of expected future deviations (e.g. effect of AIDS on mortality), and how this was taken into account
   - Assumptions for and relationship between investment items (returns, discount rates, inflation, growth in returns)
   - Way in which policyholders' reasonable expectations were provided for (e.g. future bonus rates, supportable or last declared). In the case where the maintenance of last-declared bonus rates (other than in the case of market-related policies) is not assumed for all future years, this must be disclosed with details of the reductions in bonus rates assumed. [PGN104 3.1]

4. Material changes in bases and methods since previous year and effect thereof

5. Any other descriptions or explanations to enable a lay reader to gain meaningful appreciation of the figures presented

6. Whenever less than prescribed margins have been allowed for, this fact as well as the amount by which the liability has been reduced thereby

7. The nature of any second-tier margins must be defined, and the reason for their existence as well as the broad financial effect thereof on earnings must
be disclosed. Where a provision for the expected allocation of profit to shareholders forms part of the best estimate liability (para 2.7, PGN104) it must be disclosed on a similar basis.

8. Description of the way in which asset values are smoothed, if applicable.

9. Description of the basis on which bonus stabilisation reserves are determined.

10. Any consistency adjustment should be split between the portion relating to free reserves and the portion backing policyholder liabilities.

11. A reconciliation of the increase in free reserves over the valuation period with earnings.

12. The earnings should be split into the following components:
   - Investment returns (including realised and unrealised capital appreciation/depreciation) after tax generated by free reserves. It is further recommended that this item should be split into investment income and capital appreciation.
   - Operating profit after tax from the insurance business and other activities of the insurer.
   - Changes to the valuation assumptions.
   - It is recommended that the split between new business profit and the balance be disclosed.

13. Additional disclosure is desirable, provided that it is meaningful. For example, should embedded values be supplied, then the basis of calculation as well as the assumptions must also be given to the extent necessary to make this information meaningful.

14. An appropriation of earnings between inter alia non-distributable reserves, unappropriated free reserves and distributable reserves should be given.

PGN103 4.4 A negative balance of free reserves will require explanation in the financial statements.

PGN103 4.5 If free reserves are less than the capital adequacy requirements, a commentary on the financial situation will be necessary.

PGN103 6 Capital adequacy requirements require separate disclosure in financial statements in respect of financial years commencing on or after 1 January 1995.
If differences between actuarial valuation data and accounting data cannot be reconciled and are material, that fact should be disclosed and the actuary should give an opinion of the extent to which liabilities may consequently have been under or over valued, or state what allowance has been made in the valuation to allow for the discrepancy.
Appendix I

Environment comparisons

Actuarial environment

The basis for the comparison of the actuarial environments in each of the three countries used in the benchmarking exercise conducted in this dissertation is the profit reporting method. A tabulation comparing the respective methods is given below:

<table>
<thead>
<tr>
<th>Country</th>
<th>South Africa</th>
<th>Australia</th>
<th>United Kingdom</th>
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</thead>
<tbody>
<tr>
<td>Method</td>
<td>Adjusted Financial</td>
<td>Margin on Services</td>
<td>Achieved Profits</td>
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<td>Soundness Valuation</td>
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<td>Date adopted</td>
<td>Exposure draft</td>
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<td>No</td>
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<tr>
<td>Capitalisation of assumption changes</td>
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<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Single or multiple profit carriers [2]</td>
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<td>Multiple</td>
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<td>Asset values</td>
<td>Market value</td>
<td>Market value or</td>
<td>Smoothed market value</td>
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<td></td>
<td></td>
<td>discounted cash flow</td>
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<tr>
<td>Discount rate</td>
<td>Net earned rate</td>
<td>Net earned rate</td>
<td>Net earned rate</td>
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</table>

[1] "Lock in of assumptions" means that the assumptions used at inception may not be changed during subsequent valuation throughout the policy's term.

[2] A "profit carrier" dictates how profit will be released. For instance, if premiums are chosen as the profit carrier, profit will be released in proportion to premiums.

Extracted from Kruger et al (1997)

Meyer et al (1994) point out that, although there is no single "correct" method of profit reporting, there is significant commonality between them. The common features noted by Meyer et al (1994) include:

- comprehensive, understandable and clear guidelines
- the publication of a profit figure in the financial statements, and the breakdown of such a figure into its most important components
- comprehensive disclosure requirements relating to profit recognition, including the pace of profit release and the mechanisms used to release that profit
- actuarial liabilities are calculated on prudent best estimate assumptions
• a cognisance of the importance of compliance with generally accepted accounting principles
• the necessity for disclosure to mitigate the discretion given to valuators
• the need for disclosure of the financial effects of changes to the actuarial assumptions.

On the basis that such commonality has previously been identified, and has been used to justify recommendations to the Actuarial Society of South Africa regarding profit recognition by life insurance companies in this country, there is justification in making comparisons of the actuarial disclosure between South Africa, Australia and the United Kingdom.

Insurance Environment

Introduction

Globally, insurance markets are modelled on either US or Anglo-Saxon principles. For the purposes of this dissertation, all of the selected countries follow the Anglo-Saxon approach, and as a result, there is inherent commonality between them. In all countries, the same types of products are sold, and the similar actuarial frameworks prevail.

For the purposes of justifying comparisons of their disclosure requirements, some brief background information on each of the South African, United Kingdom and Australian life insurance industries is given below.

South Africa

The life insurance market is highly competitive, but is dominated by the Old Mutual and Sanlam. As indicated earlier in this dissertation, the ten largest life companies account for roughly 95% of total premiums.

South African life companies operate in two diverse market segments, being the higher and lower income groups respectively. The lower income segment has particular growth potential, but with the advent of black economic empowerment, the higher income segment is also exhibiting some further possibilities for capturing market share.

There has been a trend towards high single premium contributions to new business in South Africa, although individual recurring business remains the most profitable.
Life insurers in South Africa are undergoing a reassessment of their traditional distribution channels, as international experience suggests that consumers are more informed and hence more demanding. The use of independent advisers is increasing. Direct marketing and retailer distribution are being explored as alternative distribution channels.

The life insurance product market is under threat from, amongst others, unit trusts, linked products and packaged products. Pure investment products are expected to grow substantially, and insurers are in a strong position to capture pure investment savings flows. However, margins on pure investment products are lower than on life insurance products, so volume growth will be critical to companies wishing to offset their compromised margins. As a consequence of this trend, most traditional life offices have positioned themselves as broadly based financial services groups.

This industry is also characterised by a move towards broader based financial services groups. A number of traditional life insurers have set up banking operations. Bancassurers have increased their share of the life insurance market. There is also an increasing convergence of the insurance and fund management industries.

The UK life industry continues to be characterised by strong competition leading to pressure on margins and a continuing need to reduce unit costs. This pressure has led to some players pricing at a loss in an effort to buy market share. The top ten companies account for about two thirds of the market (measured by new business premium income), although none has a market share greater than 15%.

Competition within the industry has been most pronounced with regard to distribution channels, product innovation and the use of technology.

Continued rationalisation of the insurance industry is expected as companies will need to achieve economies of scale to grow. Those companies without sufficient access to capital, mass or the will to reduce costs to support competitive products are expected to be acquired by or merge with stronger competitors. This will result in a move towards a decreasing number of
medium sized companies with the remaining companies as either small niche players or large companies.

Australia

Market participants fall within four general categories:
- the larger traditional life offices;
- bank-owned subsidiaries, both local and foreign;
- foreign-owned subsidiaries of international life groups; and
- smaller local life companies.

Total assets, premiums and policies in force are dominated by the three listed companies that have recently converted from mutual status - AMP, National Mutual and the newly-formed Colonial Group.

Foreign-owned life insurance companies account for 25 per cent of assets managed by the industry. Bank-owned life companies account for around 16 per cent of industry assets, although they account for around 30 per cent of all premiums.

According to Standard & Poor’s, Australia is a relatively small market with an apparent degree of overservicing. The highly competitive nature of the industry and the high regulatory insolvency requirements are likely to encourage some companies to seek greater economies of scale which will lead to consolidation and withdrawals as participants examine their long term strategic viability.

The life insurance industry in Australia exhibits a medium level of concentration. As at 31 March 1997, the top 4 players accounted for 68 per cent of total assets in statutory funds, and 50.5 per cent of total Australian premium income.

Consolidation, mergers and withdrawals are likely to remain a feature of the industry as the relatively small and mature Australian market cannot sustain the current number of authorised life insurers. The foreign-owned life companies and smaller life companies would appear to be facing the most pressure from the emerging competitive environment.
Life insurance companies face pressure to broaden their distribution channels to aid customer accessibility and convenience and to find a cost-effective distribution system. Life insurers are facing competitive pressures on margins which is forcing them to reduce the number of agents and find more economic distribution methods.

**Summary**

The principal commonalities which may be identified from the descriptions above are:

- Domination by large players, which has precipitated a trend towards consolidation.
- Margin pressure resulting from consumerism and a focus towards pure investment products, and consequently higher levels of competition.
- Changing distribution channels to seek captive markets and competitive advantages.

These observations are consistent with the introductory comment that industries modelled along Anglo-Saxon lines are broadly similar. On the basis of the demonstrated commonalities above, comparison of disclosures in these countries is meaningful.

In spite of the justification for comparison given above, it should be noted that the disclosure requirements of all countries are worth examining, irrespective of industry similarity, on the basis that disclosure is meant to give users of financial statements more insight into the overall performance, future prospects and risks inherent in the companies being examined. While the premise for the development of disclosure requirements may differ, it is the nature of the information disclosed that should be examined for its value, rather than the premise itself.
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