Münchener Rückversicherungs-Gesellschaft

Aktiengesellschaft in München

New version of IAS 32 and IAS 39
Notes on the changes and transitional provisions
Munich Re / Group Accounting
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In the International Financial Reporting Standards (IFRS) on which the Munich Re Group's accounting is based, IAS 39 and IAS 32 lay down principles governing the recognition, measurement and disclosure of information on financial instruments. Financial instruments mainly involve shares, fixed-interest securities, receivables, loans (on the assets and liabilities side), liabilities and derivatives. IAS 39 and IAS 32 do not directly apply to such items as investments in subsidiaries, associated enterprises or joint ventures. An exposure draft for the standards was published on 20 June 2002. The final standards were adopted by the IASB on 17 December 2003. The intervening period was marked by some intense discussion and controversy regarding the changes to both standards. An example of this was the debate on macro-hedging.

The main changes in IAS 39 are as follows:

- The category "held for trading" has become a subcategory of the new category "financial asset or financial liability at fair value through profit or loss". Every financial instrument can be allocated to this new category when initially recognised.
- Gains and losses on financial instruments of the "available for sale" category must be recognised in equity in future. Hitherto there has been the option of recognising such gains and losses either in the income statement or in equity. This rule does not apply to impairments, which must be recognised in the income statement in future.
- Writedowns for impairments of "available for sale" equity instruments may in future no longer be reversed via the income statement (prohibited reinstatement of values).
- Situations are described in which there are objective indications for writedowns. With equity instruments (shares), for example, such indications exist when their market value is permanent **or** significant below the amortised cost.
- The rules on disclosure in the notes have been taken over in IAS 32.
- The provisions on hedge accounting have been partially amended, which presents banks in particular with administrative challenges with regard to any earlier application of the new IAS 39.

Important changes in IAS 32 are as follows:

- More detailed disclosure of periods to maturity
- Compulsory disclosure of fair values
- More details of how fair values are calculated (methods/assumptions)
- More details on the accounting of disposals

The first-time application of the new standards is governed by transitional provisions. According to these, both standards must be applied as at 1 January 2005 at the latest. Earlier application is possible, but then the new version of IAS 32 must be used with the amended IAS 39, and vice versa.

The application of the change is governed by IAS 8. Under this, a change in accounting policy which is made on the adoption of an IAS/IFRS must generally be applied in accordance with the specific transitional provisions of that standard.

Under the transitional provisions of IAS 39, the application must be retrospective, i.e. as if the standard had always been applied. According to IAS 8, comparative information must be adjusted, which includes prior-year figures. IAS 8 also states that any other information involving prior periods, such as historical summaries of financial data, must be restated as well. Beyond this, the following information must be disclosed:

- the reasons for the change;
- the amount of the adjustment for the current period and for each period presented;
- the amount of the adjustment relating to periods prior to those included in the comparative information; and
- the fact that the comparative information has been restated or that it is impracticable to do so.

The allowed alternative treatment, which is seldom applied, is that any resulting adjustment in case of retrospective application should be included in the determination of the net profit or loss for the current period.

For the Munich Re Group, the application of the new provisions of IAS 32 and IAS 39 for the business year 2003 and the comparative figures of the previous year will – above all as a result of the more stringent rules for impairments – result in period shifts in investment income and expenses and a few related changes in the balance sheet. The presentation of Munich Re's underwriting business will remain largely unaffected. Owing to the very complex calculations, which will of course also be the subject of the subsequent external audit, sufficiently reliable forecasts on the effects are not possible before the publication of the provisional figures of the Munich Re Group's consolidated financial statements on 17 March 2004.