



**American Home Assurance Company**  
**Malaysia (991951-W)** (Incorporated in the U.S.A.)

---

OPERATIONS IN MALAYSIA

STATUTORY FINANCIAL STATEMENTS

**31 DECEMBER 2005**

# CONTENTS

---

STATUTORY DECLARATION	1
STATEMENT OF CORPORATE GOVERNANCE	2 - 3
AUDITORS' REPORT	4
STATEMENT OF ASSETS AND LIABILITIES	5
INCOME STATEMENT	6
GENERAL INSURANCE REVENUE ACCOUNT	7 - 8
CASH FLOW STATEMENT	9 - 10
NOTES TO THE FINANCIAL STATEMENTS	11 - 39

---

## **STATUTORY DECLARATION PURSUANT TO SECTION 336(6) OF THE COMPANIES ACT, 1965**

I, Brad M. Bennett, the officer primarily responsible for the financial management of the operations in Malaysia of American Home Assurance Company, do solemnly and sincerely declare that the financial statements for the financial year ended 31 December 2005 set out on pages 5 to 39 are, in my opinion, correct and I make this solemn declaration conscientiously believing the same to be true, and by virtue of the provisions of the Statutory Declarations Act, 1960.

BRAD M. BENNETT

Subscribed and solemnly declared by the abovenamed Brad M. Bennett at Kuala Lumpur on  
24 March 2006.

Before me:

T. THANDONEE RAJAGOPAL (No. W228)  
COMMISSIONER FOR OATHS

Kuala Lumpur

## STATEMENT OF CORPORATE GOVERNANCE

The Management of the operations in Malaysia of American Home Assurance Company has pleasure in submitting the statement of Corporate Governance for the financial year ended 31 December 2005.

This Statement of Corporate Governance relates only to the activities of the Malaysian Branch of American Home Assurance Company.

### MANAGEMENT ACCOUNTABILITY

The Management has a documented and well-communicated organisational structure that clearly shows lines of reporting responsibility and authority. Individual's duties and responsibilities are documented in job descriptions. Anti-Money Laundering measures are diligently practised. Disclosure of conflicts of interest is required to be made once a year for all senior management under the American International Group ("AIG") Code of Conducts.

Proper communication channels have been put in place to ensure priority information is being communicated to the right personnel. Operational manuals which document policies and procedures, internal controls and compliance are constantly reviewed and updated. These manuals and updates are circulated to all staff concerned. Our Statement of Corporate Governance is overtly reflected in policies issued.

A formal process is in place and being practised for the development of individual goals. Staff performance appraisals are done annually with half yearly reviews to ensure all goals are on track and not in conflict with the AIG corporate objectives.

### CORPORATE INDEPENDENCE

The Management ensures compliance with JPI/GPI 19 in respect of Bank Negara Malaysia ("BNM") guidelines on Related-Party Transactions.

### INTERNAL CONTROLS AND OPERATIONAL RISK MANAGEMENT

An established and effective internal control and risk management system has been put in place to enable the recognition and continued assessment of material risks that could affect the Corporation's performance and financial condition. This system is constantly being reviewed to enhance its effectiveness.

A dedicated Internal Audit team is available to carry out independent examination of the operations. The team reports to the Audit Committee based in New York.

## STATEMENT OF CORPORATE GOVERNANCE (CONTINUED)

### PUBLIC ACCOUNTABILITY

The Management maintains a practice of professionalism in its business conducts. The policyholder's rights and interests are paramount in all considerations and decisions.

### FINANCIAL REPORTING

The Management ensures that books and records for the preparation of financial statements are properly maintained in accordance with approved accounting standards. Key financial information is being made available to the public in accordance with the provision of Section 95(1) of the Insurance Act, 1996. Regular statutory reportings which were prepared with due care and diligence have been made as required by Bank Negara Malaysia.

BY THE MANAGEMENT OF AMERICAN HOME ASSURANCE COMPANY,  
OPERATIONS IN MALAYSIA

BRAD M. BENNETT  
24 March 2006

## AUDITORS' REPORT ON THE FINANCIAL STATEMENTS OF THE CORPORATION'S OPERATIONS IN MALAYSIA PURSUANT TO SECTION 336 OF THE COMPANIES ACT, 1965

We have audited the financial statements set out on pages 5 to 39 of the operations in Malaysia of American Home Assurance Company. These financial statements are the responsibility of the Corporation's directors. It is our responsibility to form an independent opinion, based on our audit, on these financial statements and to report our opinion to you in accordance with Section 174 of the Companies Act, 1965 and for no other purpose. We do not assume responsibility to any other person for the content of this report.

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

In our opinion:

- (a) the financial statements have been prepared in accordance with the provisions of the Companies Act, 1965 and MASB approved accounting standards in Malaysia so as to give a true and fair view of:
  - (i) the matters required by Section 169 of the Companies Act, 1965 to be dealt with in the financial statements; and
  - (ii) the state of affairs of the Corporation's operations in Malaysia as at 31 December 2005 and of the results and cash flows of the Corporation's operations in Malaysia for the financial year ended on that date;

and

- (b) the accounting and other records required by the Act to be kept by the Corporation's operations in Malaysia have been properly kept in accordance with the provisions of the Act.

PRICEWATERHOUSECOOPERS  
(No. AF: 1146)  
Chartered Accountants

DATO' AHMAD JOHAN BIN MOHAMMAD RASLAN  
(No. 1867/09/06 (J))  
Partner of the firm

Kuala Lumpur  
24 March 2006

**STATEMENT OF ASSETS AND LIABILITIES**

AS AT 31 DECEMBER 2005

	Note	2005 RM	2004 RM
<b>ASSETS</b>			
Property, plant and equipment	3	13,606,345	16,214,913
Investments	4	574,507,091	540,235,337
Loans	5	14,233,194	15,174,877
Receivables	6	64,949,959	60,796,511
Deferred tax assets	7	5,670,000	2,385,000
Cash and bank balances		11,667,736	7,473,033
Total assets		<u>684,634,325</u>	<u>642,279,671</u>
<b>LIABILITIES</b>			
Provision for outstanding claims	8	173,070,860	164,053,087
Payables	9	68,281,051	70,683,136
Current tax liabilities		10,579,982	1,898,617
		<u>251,931,893</u>	<u>236,634,840</u>
Unearned premium reserves	10	178,003,515	193,255,108
Total liabilities		429,935,408	429,889,948
<b>HEAD OFFICE ACCOUNT</b>	11	254,698,917	212,389,723
Total liabilities and amount due to Head Office		<u>684,634,325</u>	<u>642,279,671</u>

*The accompanying notes form an integral part of these financial statements.*

**INCOME STATEMENT**

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2005

	Note	2005 RM	2004 RM
Operating revenue	12	<u>473,869,476</u>	<u>462,989,504</u>
Shareholders' fund:			
Investment income	13	1,722,790	1,664,374
Other operating income - net	14	3,682	261,435
		<u>1,726,472</u>	<u>1,925,809</u>
Surplus transferred from General Insurance Revenue Account		<u>81,419,890</u>	<u>48,131,474</u>
Profit before taxation		83,146,362	50,057,283
Taxation	15	(22,837,168)	(15,916,101)
Net profit for the financial year		<u>60,309,194</u>	<u>34,141,182</u>

*The accompanying notes form an integral part of these financial statements.*



**GENERAL INSURANCE REVENUE ACCOUNT**

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2005

	Note	Fire RM	Motor RM	Marine, aviation and transit RM	Miscellaneous RM	Total RM
Gross premium		116,961,054	163,518,946	15,883,729	153,011,674	449,375,403
Reinsurance		(83,666,167)	(12,439,924)	(11,249,888)	(55,560,996)	(162,916,975)
Net premium		<u>33,294,887</u>	<u>151,079,022</u>	<u>4,633,841</u>	<u>97,450,678</u>	<u>286,458,428</u>
Decrease/(increase) in unearned premium reserves	10	<u>24,906,934</u>	<u>(1,556,942)</u>	<u>(4,013,049)</u>	<u>(4,085,350)</u>	<u>15,251,593</u>
Earned premium		<u>58,201,821</u>	<u>149,522,080</u>	<u>620,792</u>	<u>93,365,328</u>	<u>301,710,021</u>
Net claims incurred	16	<u>(14,590,432)</u>	<u>(105,566,252)</u>	<u>(2,261,692)</u>	<u>(31,353,621)</u>	<u>(153,771,997)</u>
Net commission		<u>6,574,709</u>	<u>(17,715,350)</u>	<u>669,300</u>	<u>(8,480,040)</u>	<u>(18,951,381)</u>
Underwriting surplus/ (deficit) before management expenses		<u>50,186,098</u>	<u>26,240,478</u>	<u>(971,600)</u>	<u>53,531,667</u>	<u>128,986,643</u>
Management expenses	17					<u>(72,287,318)</u>
Underwriting surplus						<u>56,699,325</u>
Investment income	13					<u>22,771,283</u>
Other operating income - net	14					<u>1,949,282</u>
Surplus transferred to Income Statement						<u>81,419,890</u>

*The accompanying notes form an integral part of these financial statements.*

**GENERAL INSURANCE REVENUE ACCOUNT**

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2004

	<b>Note</b>	<b>Fire RM</b>	<b>Motor RM</b>	<b>Marine, aviation and transit RM</b>	<b>Miscellaneous RM</b>	<b>Total RM</b>
Gross premium		132,120,313	153,779,117	8,783,757	146,446,734	441,129,921
Reinsurance		(92,765,510)	(13,560,149)	(4,965,859)	(57,734,212)	(169,025,730)
Net premium		<u>39,354,803</u>	<u>140,218,968</u>	<u>3,817,898</u>	<u>88,712,522</u>	<u>272,104,191</u>
(Increase)/decrease in unearned premium reserves	10	(40,461,984)	(4,933,032)	361,688	24,002,275	(21,031,053)
Earned premium		<u>(1,107,181)</u>	<u>135,285,936</u>	<u>4,179,586</u>	<u>112,714,797</u>	<u>251,073,138</u>
Net claims incurred	16	(14,019,762)	(97,804,000)	(1,874,798)	(36,339,935)	(150,038,495)
Net commission		<u>7,553,916</u>	<u>(14,751,218)</u>	<u>140,966</u>	<u>(5,795,359)</u>	<u>(12,851,695)</u>
Underwriting (deficit)/ surplus before management expenses		<u>(7,573,027)</u>	<u>22,730,718</u>	<u>2,445,754</u>	<u>70,579,503</u>	<u>88,182,948</u>
Management expenses	17					(63,016,420)
Underwriting surplus						<u>25,166,528</u>
Investment income	13					20,195,209
Other operating income - net	14					<u>2,769,737</u>
Surplus transferred to Income Statement						<u>48,131,474</u>

*The accompanying notes form an integral part of these financial statements.*

**CASH FLOW STATEMENT**

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2005

	Note	2005 RM	2004 RM
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net profit for the financial year		60,309,194	34,141,182
Adjustments for:			
Property, plant and equipment			
- depreciation		3,551,036	3,333,069
- gain on disposal		(73,205)	(23,000)
Investment income		(24,494,073)	(21,859,583)
Allowance for diminution in value of investments		695,489	-
Gain on disposal of investments		(2,059,093)	(2,723,934)
(Decrease)/increase in unearned premium reserves		(15,251,593)	21,031,053
Taxation		22,837,168	15,916,101
Bad debts written off		978,376	444,739
Increase/(decrease) in allowance for doubtful debts		1,176,550	(3,308,693)
		<u>47,669,849</u>	<u>46,950,934</u>
Decrease/(increase) in fixed deposits		561,116	(42,323,754)
Increase in provision for outstanding claims		9,017,773	10,897,599
(Decrease)/increase in trade payables		(7,760,733)	4,475,737
Increase/(decrease) in other payables		5,358,648	(20,173,014)
Decrease in loans		941,683	1,082,373
Increase in trade receivables		(5,620,366)	(19,116,447)
(Increase)/decrease in other receivables		(165,756)	1,010,704
Interest income received		28,886,228	29,087,517
Dividend received		1,249,588	656,814
Proceeds from disposal of investments		147,905,754	260,198,416
Purchase of investments		(187,539,015)	(274,900,196)
Cash generated from/(used in) operations		<u>40,504,769</u>	<u>(2,153,317)</u>
Tax refunded		-	906,435
Tax paid		(17,440,803)	(12,986,336)
Net cash inflow/(outflow) from operating activities	18	<u>23,063,966</u>	<u>(14,233,218)</u>

**CASH FLOW STATEMENT**

FOR THE FINANCIAL YEAR ENDED 31 DECEMBER 2005 (CONTINUED)

	Note	2005 RM	2004 RM
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Proceeds from disposal of property, plant and equipment		91,067	30,319
Purchase of property, plant and equipment		(960,330)	(2,010,598)
Net cash outflow from investing activities	18	<u>(869,263)</u>	<u>(1,980,279)</u>
<b>CASH FLOW FROM FINANCING ACTIVITIES</b>			
Transfer to Head Office		(18,000,000)	(15,000,000)
Net cash outflow from financing activities	18	<u>(18,000,000)</u>	<u>(15,000,000)</u>
<b>NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS</b>	18	4,194,703	(31,213,497)
<b>CASH AND CASH EQUIVALENTS AT 1 JANUARY</b>		<u>7,473,033</u>	<u>38,686,530</u>
<b>CASH AND CASH EQUIVALENTS AT 31 DECEMBER</b>		<u>11,667,736</u>	<u>7,473,033</u>
Cash and cash equivalents comprise:			
Cash and bank balances		<u>11,667,736</u>	<u>7,473,033</u>

*The accompanying notes form an integral part of these financial statements.*

## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005

### 1 PRINCIPAL ACTIVITY AND GENERAL INFORMATION

The principal activity of the Corporation's operations in Malaysia ("the Branch") is the underwriting of all classes of general insurance business. There has been no significant change in the nature of this activity during the financial year.

The number of employees as at the end of the financial year in the Branch was 555 (2004: 597).

The ultimate holding corporation of American Home Assurance Company is American International Group, Inc., a corporation incorporated in the United States of America.

The address of the registered office and principal place of business of the Branch is Wisma AIG, No 99, Jalan Ampang, 50450 Kuala Lumpur.

The financial statements were authorised for issue on 24 March 2006.

### 2 SIGNIFICANT ACCOUNTING POLICIES

The following accounting policies have been used consistently in dealing with items which are considered material in relation to the financial statements.

#### (a) Basis of preparation

The financial statements of the Branch have been prepared under the historical cost convention and comply with the Malaysian Accounting Standard Board ("MASB") approved accounting standards in Malaysia, the provisions of the Companies Act, 1965, the Insurance Act, 1996 and relevant Guidelines and Circulars issued by Bank Negara Malaysia ("BNM") in all material aspects.

The preparation of financial statements in conformity with the provisions of the Companies Act, 1965 and MASB approved accounting standards in Malaysia requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reported financial year. Although these estimates are based on the Management's best knowledge of current events and actions, actual results may differ from estimates.

## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### (b) Property, plant and equipment

Property, plant and equipment are stated at cost or valuation less accumulated depreciation and accumulated impairment losses.

Depreciation of property, plant and equipment is provided on a straight line basis calculated to write off the cost of each asset over the estimated useful lives of the assets concerned. The annual rates used are:

Furniture and equipment	10% - 20%
Computer equipment	10% - 20%
Motor vehicles	20%
Renovation	5% - 20%

At each financial year end, the Branch assesses whether there is any indication of impairment. If such indications exist, an analysis is performed to assess whether the carrying amount of the asset is fully recoverable. A write down is made if the carrying amount exceeds the recoverable amount. See accounting policy Note 2(g) on impairment of assets.

Gains and losses on disposals are determined by comparing proceeds with carrying amounts and are credited or charged to the revenue account and/or income statement.

Repairs and maintenance are charged to the revenue account and/or income statement during the financial year in which they are incurred. The cost of major renovations is included in the carrying amount of the asset when it is probable that future economic benefits in excess of the originally assessed standard of performance of the existing asset will flow to the Branch. Major renovations are depreciated over the remaining useful life of the related assets.

### (c) Foreign currencies

Foreign currency transactions in the Branch are accounted for at the exchange rates prevailing at the transaction dates. Foreign currency monetary assets and liabilities are translated at the exchange rates prevailing at the date of the statement of assets and liabilities. Exchange differences arising from the settlement of foreign currency transactions and from the translation of foreign currency monetary assets and liabilities are included in the income statement and/or revenue account.

The principal closing rates used in the translation of foreign currency amounts as at the financial year end are as follows:

Foreign currency	2005	2004
United States Dollar	3.779	3.800
Singapore Dollar	2.270	2.246
Hong Kong Dollar	0.487	0.494

## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### (d) Investments

Malaysian Government Securities, Cagamas papers and other unquoted approved debt securities as specified by BNM which are intended to be held to maturity, are stated at cost, adjusted for the amortisation of premiums or accretion of discounts, calculated on a constant yield basis, from the date of purchase to maturity date. The amortisation of premiums and accretion of discounts are recognised in the revenue account and /or income statement.

Quoted investments are stated at the lower of cost and market value determined on an aggregate portfolio basis by each category of investments, except that where diminution in value of a particular investment is not regarded as temporary, specific allowance is made against the value of that investment. Market value is determined by reference to the stock exchange closing price at the date of the statement of assets and liabilities.

Unquoted investments are stated at cost and an allowance for diminution in value is made where, in the opinion of the Management, there is a decline other than temporary in the value of such investments. Where there has been a decline other than temporary in the value of an investment, such a decline is recognised as an expense in the financial year in which the decline is identified.

### (e) Employee benefits

#### (i) Short-term employees benefits

Wages, salaries, paid annual leave and sick leave, bonuses and non-monetary benefits are accrued in the financial year in which the associated services are rendered by employees of the Branch.

#### (ii) Post-employment benefits

The Branch's contributions to the Employees' Provident Fund, the national defined contribution plan, are charged to the income statement and/or revenue account in the financial year to which they relate. Once the contributions have been paid, the Branch has no further payment obligations.

### (f) Trade receivables

Trade receivables are carried at invoiced amount less an allowance made for doubtful debts.

Known bad debts are written off and specific allowance is made for any debt considered to be doubtful of collection. In addition, allowance is made for any premiums, including agents' balances or reinsurance balances, which remain outstanding for more than 6 months from the date on which they become receivable, except for outstanding motor premiums for which allowance is made for amounts outstanding for more than 30 days.

## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### (g) Impairment of assets

The carrying values of assets are reviewed for impairment when there is an indication that the assets might be impaired. Impairment is measured by comparing the carrying values of the assets with their recoverable amounts. The recoverable amount is the higher of the net realisable value and the value in use, which is measured by reference to discounted cash flows. Recoverable amounts are estimated for individual assets, or, if it is not possible, for the cash-generating unit.

An impairment loss is charged to the revenue account and/or income statement immediately.

A subsequent increase in the recoverable amount of an asset is treated as reversal of the previous impairment loss and is recognised to the extent of the carrying amount of the asset that would have been determined (net of amortisation and depreciation) had no impairment loss been recognised. The reversal is recognised in the revenue account and/or income statement immediately.

### (h) Operating leases

Leases of assets where a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases are charged to the income statement and revenue account on a straight line basis over the lease period.

When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the financial year in which termination takes place.

### (i) General insurance underwriting results

The general insurance underwriting results are determined for each class of business after taking into account reinsurances, commissions, unearned premiums and claims incurred.

#### Premium income

Premium income is recognised in a financial year in respect of risks assumed during that particular financial year. Premiums from direct business are recognised during the financial year upon the issuance of premium debit notes. Premiums in respect of risks incepted for which debit notes have not been issued as of the date of the statement of assets and liabilities are accrued at the date.

Inward treaty reinsurance premiums are recognised on the basis of periodic advices received from ceding insurers.

Outward reinsurance premiums are recognised in the same accounting period as the original policy to which the reinsurance relates.



## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### Unearned premium reserves

Unearned premium reserves ("UPR") represent the portion of the net premiums of insurance policies written that relate to the unexpired periods of the policies at the end of the financial year.

In determining the UPR, the method that most accurately reflects the actual unearned premium is used. UPR is computed with reference to the month of accounting for the premium on the following bases:

- (i) 25% method for marine cargo, aviation cargo and transit business;
- (ii) 1/24th method for all other classes of general business in respect of Malaysian policies, reduced by the percentage of accounted gross direct business commission to the corresponding premium, not exceeding limits specified by BNM; and
- (iii) time apportionment method for non-annual policies, reduced by the percentage of accounted gross direct business commissions to the corresponding premiums, not exceeding limits specified by BNM.

In previous financial years, the UPR in respect of Medical & Health and Personal Accident policies with duration of less than 12 months were computed using the 1/24th method.

In the current financial year, the UPR computation basis of these policies was changed to the time apportionment method.

The change in estimate has resulted in an increase in the Branch's net profit for the financial year of RM11,063,534.

### Provision for claims

A liability for outstanding claims is recognised in respect of both direct insurance and inward reinsurance. The amount of outstanding claims is the best estimate of the expenditure required together with related expenses less recoveries to settle the present obligation at the date of the statement of assets and liabilities.

Provision is also made for the cost of claims, together with related expenses, incurred but not reported ("IBNR") at the date of the statement of assets and liabilities, based on an actuarial valuation carried out by an independent professional actuary, using a proper and consistent method of estimation based on properly collated claims statistics.

### Acquisition costs

The cost of acquiring and renewing insurance policies net of income derived from ceding reinsurance premiums is recognised as incurred and properly allocated to the financial periods in which it is probable they give rise to income.

## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### (j) Other revenue recognition

Interest income on loans is recognised on an accrual basis except where a loan is considered non-performing, i.e. where repayments are in arrears for more than six months, in which case recognition of such interest is suspended. Subsequent to suspension, interest is recognised on the receipt basis until all arrears have been paid.

Other interest income, including the amount of amortisation of premiums and accretion of discounts, is recognised on a time proportion basis that takes into account the effective yield of the asset.

Dividend income is recognised when the right to receive payment is established.

Gains or losses arising on disposal of investments are credited or charged to the revenue account and/or income statement.

### (k) Income taxes

Current tax expense is determined according to the tax laws of the jurisdiction in which the Branch operates and includes all taxes based upon the taxable profits.

Deferred tax is recognised in full, using the liability method, on temporary differences arising between the amounts attributed to assets and liabilities for tax purpose and their carrying amounts in the financial statements.

Deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which the deductible temporary differences or unused tax losses can be utilised.

Tax rates enacted or substantively enacted by the statement of assets and liabilities date are used to determine deferred tax.

### (l) Contingent liabilities and contingent assets

The Branch does not recognise a contingent liability but discloses its existence in the financial statements. A contingent liability is a possible obligation that arises from past events whose existence will be confirmed by uncertain future events beyond the control of the Branch or a present obligation that is not recognised because it is not probable that an outflow of resources will be required to settle the obligation. A contingent liability also arises in the extremely rare case where there is a liability that cannot be recognised because it cannot be measured reliably.

A contingent asset is a possible asset that arises from past events whose existence will be confirmed by uncertain future events beyond the control of the Branch. The Branch does not recognise contingent assets but discloses its existence where inflows of economic benefits are probable, but not virtually certain.

### (m) Provisions

Provisions are recognised when the Branch has a present legal or constructive obligation as a result of past events, when it is probable that an outflow of resources will be required to settle the obligation, and when a reliable estimate of the amount can be made.

## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### (n) Cash and cash equivalents

Cash and cash equivalents consist of cash and bank balances excluding fixed and call deposits, that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

### (o) Financial instruments

#### Description

A financial instrument is any contract that gives rise to both a financial asset of one enterprise and a financial liability or equity instrument of another enterprise.

A financial asset is any asset that is cash, a contractual right to receive cash or another financial asset from another enterprise, a contractual right to exchange financial instruments with another enterprise under conditions that are potentially favourable, or an equity instrument of another enterprise.

A financial liability is any liability that is a contractual obligation to deliver cash or another financial asset to another enterprise, or to exchange financial instruments with another enterprise under conditions that are potentially unfavourable.

#### Recognition method

The particular recognition method adopted for financial instruments recognised on the statement of assets and liabilities date is disclosed in the individual accounting policy note associated with each item.

#### Fair values

The Branch's basis of estimation of fair values for financial instruments is as follows:

Component	Method of determining fair values
<ul style="list-style-type: none"> <li>Malaysian Government Securities and Cagamas papers</li> </ul>	<ul style="list-style-type: none"> <li>Indicative market prices</li> </ul>
<ul style="list-style-type: none"> <li>Unquoted corporate debt securities</li> </ul>	<ul style="list-style-type: none"> <li>Indicative market prices from a financial institution</li> </ul>
<ul style="list-style-type: none"> <li>Quoted securities</li> </ul>	<ul style="list-style-type: none"> <li>Quoted market prices</li> </ul>
<ul style="list-style-type: none"> <li>Loans receivable</li> </ul>	<ul style="list-style-type: none"> <li>Discounted future cash flows based on the contracted maturity period. Discount rates are based on current market interest rates</li> </ul>
<ul style="list-style-type: none"> <li>Other financial assets and liabilities with a maturity period of less than one year</li> </ul>	<ul style="list-style-type: none"> <li>Carrying values assumed to approximate their fair values</li> </ul>

## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### 3 PROPERTY, PLANT AND EQUIPMENT

	Furniture and equipment RM	Computer equipment RM	Motor vehicles RM	Renovation RM	Total RM
<b>Financial year ended</b>					
<b>31 December 2005</b>					
Net book value at					
1 January 2005	5,590,200	3,831,399	39,667	6,753,647	16,214,913
Additions at cost	150,339	501,722	276,165	32,103	960,329
Disposals at net book value	(840)	(5,688)	(11,335)	-	(17,863)
Depreciation charge	(829,385)	(2,063,160)	(46,747)	(611,742)	(3,551,034)
	<u>4,910,314</u>	<u>2,264,273</u>	<u>257,750</u>	<u>6,174,008</u>	<u>13,606,345</u>
Net book value at					
31 December 2005	<u>4,910,314</u>	<u>2,264,273</u>	<u>257,750</u>	<u>6,174,008</u>	<u>13,606,345</u>
<b>At 31 December 2005</b>					
Cost	6,783,030	16,633,392	436,165	7,670,596	31,523,183
Accumulated depreciation	(1,872,716)	(14,369,118)	(178,414)	(1,496,590)	(17,916,838)
	<u>4,910,314</u>	<u>2,264,274</u>	<u>257,751</u>	<u>6,174,006</u>	<u>13,606,345</u>
<b>Financial year ended</b>					
<b>31 December 2004</b>					
Net book value at					
1 January 2004	6,041,341	4,624,667	103,000	6,775,695	17,544,703
Additions at cost	342,994	1,095,605	-	571,999	2,010,598
Disposals at net book value	-	(7,319)	-	-	(7,319)
Depreciation charge	(794,135)	(1,881,554)	(63,333)	(594,047)	(3,333,069)
	<u>5,590,200</u>	<u>3,831,399</u>	<u>39,667</u>	<u>6,753,647</u>	<u>16,214,913</u>
Net book value at					
31 December 2004	<u>5,590,200</u>	<u>3,831,399</u>	<u>39,667</u>	<u>6,753,647</u>	<u>16,214,913</u>
<b>At 31 December 2004</b>					
Cost	6,634,291	16,141,323	330,000	7,638,493	30,744,107
Accumulated depreciation	(1,044,091)	(12,309,924)	(290,333)	(884,846)	(14,529,194)
	<u>5,590,200</u>	<u>3,831,399</u>	<u>39,667</u>	<u>6,753,647</u>	<u>16,214,913</u>

## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### 3 PROPERTY, PLANT AND EQUIPMENT *(Continued)*

Included in the cost of property, plant and equipment are the following fully depreciated property, plant and equipment which are still in use:

	<b>2005</b>	<b>2004</b>
	<b>RM</b>	<b>RM</b>
Furniture and equipment	45,770	4,850
Computer equipment	129,658	-
Motor vehicles	160,000	160,000
Renovation	127,113	-
	<u>462,541</u>	<u>164,850</u>

### 4 INVESTMENTS

	<b>2005</b>		<b>2004</b>	
	<b>Carrying value RM</b>	<b>Market value RM</b>	<b>Carrying value RM</b>	<b>Market value RM</b>
Malaysian Government Securities, at cost	263,957,031		244,723,077	
Amortisation of premiums - net	(6,855,247)		(4,103,242)	
	<u>257,101,784</u>	<u>258,020,300</u>	<u>240,619,835</u>	<u>241,672,000</u>
Cagamas papers, at cost	50,445,255		70,510,300	
Amortisation of premiums - net	(257,519)		(17,922)	
	<u>50,187,736</u>	<u>49,968,000</u>	<u>70,492,378</u>	<u>70,306,000</u>
Quoted:				
Equity securities of corporations:				
Quoted in Malaysia, at cost	36,061,815		22,692,963	
Allowance for diminution in value	(695,489)		-	
	<u>35,366,326</u>	<u>35,366,326</u>	<u>22,692,963</u>	<u>25,336,028</u>
Real estate investment trust, at cost	<u>1,477,823</u>	<u>1,692,060</u>	-	-

## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### 4 INVESTMENTS (Continued)

	2005		2004	
	Carrying value RM	Market value RM	Carrying value RM	Market value RM
Unquoted:				
Corporate debt securities, at cost	106,606,438		81,618,850	
Amortisation of premiums - net	(1,738,442)		(1,255,231)	
	<u>104,867,996</u>		<u>80,363,619</u>	
Other investments	220,000		220,000	
Fixed deposits with licensed banks	125,285,426		125,846,542	
Total investments	<u>574,507,091</u>		<u>540,235,337</u>	

The maturity structure of Malaysian Government Securities, Cagamas papers, corporate debt securities and fixed deposits above is as follows:

	2005 Carrying value RM	2004 Carrying value RM
Investments maturing within 12 months	80,579,258	9,200,000
Investments maturing after 12 months	456,863,684	508,122,374
	<u>537,442,942</u>	<u>517,322,374</u>

### 5 LOANS

	2005 RM	2004 RM
Unsecured staff loans	6,049,801	6,774,610
Allowance for doubtful debts	(112,061)	(349,733)
	<u>5,937,740</u>	<u>6,424,877</u>
Secured loans	8,295,454	8,750,000
	<u>14,233,194</u>	<u>15,174,877</u>
Receivable within 12 months	1,238,844	1,090,777
Receivable after 12 months	12,994,350	14,084,100
	<u>14,233,194</u>	<u>15,174,877</u>

## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### 6 RECEIVABLES

	2005 RM	2004 RM
<b>Trade receivables</b>		
Due premiums including agents, brokers and co-insurers balances	50,529,635	45,204,947
Allowance for doubtful debts	(7,375,504)	(4,407,936)
	<u>43,154,131</u>	<u>40,797,011</u>
Due from reinsurers and cedants	15,393,155	15,858,863
Allowance for doubtful debts	(7,411,746)	(8,985,774)
	<u>7,981,409</u>	<u>6,873,089</u>
	<u>51,135,540</u>	<u>47,670,100</u>
<b>Other receivables</b>		
Interest income due and accrued	6,917,301	6,395,049
Assets held under Malaysian Motor Insurance Pool	2,470,398	2,654,222
Other receivables, deposits and prepayments	3,150,619	3,386,398
Amount due from related corporations (Note 19)	1,276,101	690,742
	<u>13,814,419</u>	<u>13,126,411</u>
	<u>64,949,959</u>	<u>60,796,511</u>

The amount due from related corporations is unsecured, interest-free and has no fixed terms of repayment.

The currency exposure of the amount due from related corporations is set out below:

	2005 RM	2004 RM
Ringgit Malaysia	263,279	98,517
United States Dollar	1,012,822	592,225
	<u>1,276,101</u>	<u>690,742</u>

## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### 7 DEFERRED TAX ASSETS

Deferred tax assets and liabilities are offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when the deferred taxes relate to the same tax authority.

The following amounts, determined after appropriate offsetting, are shown in the statement of assets and liabilities:

	2005 RM	2004 RM
Subject to income tax:		
Deferred tax assets	5,670,000	2,385,000
At 1 January	2,385,000	4,193,000
Credited/(charged) to Income Statement (Note 15):	3,285,000	(1,808,000)
- property, plant and equipment	598,000	(122,000)
- investments	976,000	(740,000)
- trade receivables	907,000	(1,317,000)
- other receivables	(241,000)	452,000
- unearned premium reserves	1,045,000	(81,000)
At 31 December	5,670,000	2,385,000
Subject to income tax:		
<u>Deferred tax assets (before offsetting)</u>		
Investments	2,478,000	1,502,000
Trade receivables	3,675,000	2,768,000
Unearned premium reserves	1,348,000	303,000
	7,501,000	4,573,000
Offsetting	(1,831,000)	(2,188,000)
Deferred tax assets (after offsetting)	5,670,000	2,385,000
<u>Deferred tax liabilities (before offsetting)</u>		
Property, plant and equipment	758,000	1,356,000
Other receivables	1,073,000	832,000
	1,831,000	2,188,000
Offsetting	(1,831,000)	(2,188,000)
Deferred tax liabilities (after offsetting)	-	-



## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### 8 PROVISION FOR OUTSTANDING CLAIMS

	2005 RM	2004 RM
Provision for outstanding claims	272,593,378	246,030,237
Recoverable from reinsurers	(99,522,518)	(81,977,150)
Net outstanding claims	<u>173,070,860</u>	<u>164,053,087</u>

### 9 PAYABLES

#### Trade payables

Due to agents, brokers, co-insurers and insureds

Due to reinsurers and cedants

26,348,279	24,408,969
31,020,410	40,720,453
<u>57,368,689</u>	<u>65,129,422</u>

#### Other payables

Payroll liabilities

Service tax and stamp duty payable

Accrual for Insurance Guarantee Scheme Fund levy

Accrued expenses

Accrued capital expenditure

Other payables

789,821	653,816
1,456,175	2,229,161
988,387	991,741
7,044,628	879,671
165,096	382,750
468,255	416,575
<u>10,912,362</u>	<u>5,553,714</u>
<u>68,281,051</u>	<u>70,683,136</u>

## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### 10 UNEARNED PREMIUM RESERVES

	Fire RM	Motor RM	Marine, aviation and transit RM	Miscellaneous RM	Total RM
<b>2005</b>					
<b>Short term</b>					
At 1 January 2005	63,441,216	67,691,251	2,092,460	55,782,046	189,006,973
(Decrease)/increase in reserves	(24,906,934)	1,556,942	790,133	(6,410,974)	(28,970,833)
At 31 December 2005	<u>38,534,282</u>	<u>69,248,193</u>	<u>2,882,593</u>	<u>49,371,072</u>	<u>160,036,140</u>
<b>Long term</b>					
At 1 January 2005	-	-	-	4,248,135	4,248,135
Increase in reserves	-	-	3,222,916	10,496,324	13,719,240
At 31 December 2005	<u>-</u>	<u>-</u>	<u>3,222,916</u>	<u>14,744,459</u>	<u>17,967,375</u>
Total	<u>38,534,282</u>	<u>69,248,193</u>	<u>6,105,509</u>	<u>64,115,531</u>	<u>178,003,515</u>
<b>2004</b>					
<b>Short term</b>					
At 1 January 2004	22,979,232	62,758,219	2,454,148	84,032,456	172,224,055
Increase/(decrease) in reserves	40,461,984	4,933,032	(361,688)	(28,250,410)	16,782,918
At 31 December 2004	<u>63,441,216</u>	<u>67,691,251</u>	<u>2,092,460</u>	<u>55,782,046</u>	<u>189,006,973</u>
<b>Long term</b>					
At 1 January 2004	-	-	-	-	-
Increase in reserves	-	-	-	4,248,135	4,248,135
At 31 December 2004	<u>-</u>	<u>-</u>	<u>-</u>	<u>4,248,135</u>	<u>4,248,135</u>
Total	<u>63,441,216</u>	<u>67,691,251</u>	<u>2,092,460</u>	<u>60,030,181</u>	<u>193,255,108</u>

## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### 11 HEAD OFFICE ACCOUNT

	2005 RM	2004 RM
<u>Working capital</u>		
At 1 January/31 December	100,000,000	100,000,000
<u>Distributable</u>		
Retained Earnings:		
At 1 January	112,389,723	93,248,541
Net profit for the financial year	60,309,194	34,141,182
Transfer to Head Office	(18,000,000)	(15,000,000)
	<u>154,698,917</u>	<u>112,389,723</u>
	<u>254,698,917</u>	<u>212,389,723</u>

### 12 OPERATING REVENUE

	2005		
	Shareholders' fund RM	General fund RM	Total RM
Gross premium	-	449,375,403	449,375,403
Investment income (Note 13)	1,722,790	22,771,283	24,494,073
	<u>1,722,790</u>	<u>472,146,686</u>	<u>473,869,476</u>
	2004		
	Shareholders' fund RM	General fund RM	Total RM
Gross premium	-	441,129,921	441,129,921
Investment income (Note 13)	1,664,374	20,195,209	21,859,583
	<u>1,664,374</u>	<u>461,325,130</u>	<u>462,989,504</u>

## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### 13 INVESTMENT INCOME

	2005 RM	2004 RM
<b>General fund</b>		
Interest from:		
Fixed deposits	6,350,436	5,536,260
Malaysian Government securities	14,685,676	13,272,365
Cagamas papers	479,076	436,415
Unquoted corporate debt securities	4,958,830	4,895,890
Secured loans	1,010,366	1,050,949
Amortisation of premiums, net of accretion of discounts	(5,962,689)	(5,653,484)
Gross dividends from quoted equity securities in Malaysia	1,249,588	656,814
	<u>22,771,283</u>	<u>20,195,209</u>
<b>Shareholders' fund</b>		
Interest from:		
Fixed deposits	87,621	30,902
Malaysian Government securities	-	1,882,631
Cagamas papers	1,649,365	728,179
Unquoted corporate debt securities	187,110	-
Amortisation of premiums, net of accretion of discounts	(201,306)	(977,338)
	<u>1,722,790</u>	<u>1,664,374</u>

### 14 OTHER OPERATING INCOME - NET

<b>General fund</b>		
Gain on disposal of property, plant and equipment	73,205	23,000
Gain on disposal of investments	2,055,411	2,462,499
Allowance for diminution in value of investments	(695,489)	-
Sundry income	693,912	323,530
Sundry expenses	(177,757)	(39,292)
	<u>1,949,282</u>	<u>2,769,737</u>

## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### 14 OTHER OPERATING INCOME - NET (Continued)

	2005 RM	2004 RM
<b>Shareholders' fund</b>		
Gain on disposal of investments	3,682	261,435

### 15 TAXATION

	2005 RM	2004 RM
<b>Current tax</b>		
Current financial year	28,160,276	15,132,000
Overprovision of tax in prior financial years	(2,038,108)	(1,023,899)
	26,122,168	14,108,101
<b>Deferred tax</b>		
Origination and reversal of temporary differences (Note 7)	(3,285,000)	1,808,000
Tax expense	22,837,168	15,916,101

The explanation of the relationship between tax expense and profit before taxation is as follows:

	2005 RM	2004 RM
Profit before taxation	83,146,362	50,057,283
Tax calculated at the Malaysian tax rate of 28% (2004: 28%)	23,280,981	14,016,039
Overprovision of tax for prior financial year	(2,038,108)	(1,023,899)
Tax effects of expenses not deductible for tax purposes	1,594,295	2,923,961
Tax expense	22,837,168	15,916,101

## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### 16 NET CLAIMS INCURRED

	Fire RM	Motor RM	Marine, aviation and transit RM	Miscellaneous RM	Total RM
<b>2005</b>					
Gross claims paid less salvage	27,600,865	102,113,648	5,396,024	62,613,926	197,724,463
Reinsurance recoveries	(17,491,252)	(5,437,060)	(2,898,268)	(27,143,659)	(52,970,239)
Net claims paid	10,109,613	96,676,588	2,497,756	35,470,267	144,754,224
Net outstanding claims:					
At 31 December 2005	15,996,718	94,970,283	2,596,469	59,507,390	173,070,860
At 1 January 2005	(11,515,899)	(86,080,619)	(2,832,533)	(63,624,036)	(164,053,087)
Net claims incurred	<u>14,590,432</u>	<u>105,566,252</u>	<u>2,261,692</u>	<u>31,353,621</u>	<u>153,771,997</u>
<b>2004</b>					
Gross claims paid less salvage	31,684,807	105,784,070	5,923,065	42,334,918	185,726,860
Reinsurance recoveries	(19,873,728)	(5,943,122)	(3,168,989)	(17,600,125)	(46,585,964)
Net claims paid	11,811,079	99,840,948	2,754,076	24,734,793	139,140,896
Net outstanding claims:					
At 31 December 2004	11,515,899	86,080,619	2,832,533	63,624,036	164,053,087
At 1 January 2004	(9,307,216)	(88,117,567)	(3,711,811)	(52,018,894)	(153,155,488)
Net claims incurred	<u>14,019,762</u>	<u>97,804,000</u>	<u>1,874,798</u>	<u>36,339,935</u>	<u>150,038,495</u>

## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### 17 MANAGEMENT EXPENSES

	2005 RM	2004 RM
<u>General fund</u>		
Staff salaries and bonus	24,409,564	22,009,458
Staff benefits	7,667,714	4,772,254
	<hr/>	<hr/>
Staff costs	32,077,278	26,781,712
Auditors' remuneration:		
Statutory audit	84,500	83,000
Fees for other services	8,160	25,429
Travelling expenses	436,471	588,541
Motor vehicle expenses	873,653	818,545
Legal expenses	198,960	82,510
Advertising	4,145,368	5,082,165
Printing and stationery	2,598,821	3,542,738
Rent and rates	4,533,427	4,571,768
Electricity and water	474,885	560,213
Postage, telephone, telex and telefax	5,682,075	6,195,338
Office maintenance	467,506	315,539
Entertainment	562,202	1,377,527
Depreciation of property, plant and equipment	3,551,036	3,333,069
Training expenses	998,874	1,075,414
Insurance Guarantee Scheme Fund levy	814,273	736,468
EDP expenses	7,038,194	6,055,725
Bad debts written off	978,396	444,739
Bad debts recovered	(128,052)	(56,391)
Increase/(decrease) in allowance for doubtful debts	1,176,550	(3,308,693)
Other expenses	5,714,741	4,711,064
	<hr/>	<hr/>
	72,287,318	63,016,420

The charge to the income statement for the financial year ended 31 December 2005 in respect of contributions to the Employees' Provident Fund is RM3,487,982 (2004: RM3,119,810).

The remuneration, including benefits-in-kind, attributable to the Chief Executive Officer of the Branch during the financial year amounted to RM607,312 (2004: RM447,181).

## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### 18 CASH FLOW SEGMENT INFORMATION

	Shareholders' fund RM	General fund RM	Total RM
<b>2005</b>			
Cash flows from:			
Operating activities	18,425,974	4,637,992	23,063,966
Investing activities	-	(869,263)	(869,263)
Financing activities	(18,000,000)	-	(18,000,000)
Net increase in cash and cash equivalents	<u>425,974</u>	<u>3,768,729</u>	<u>4,194,703</u>
Cash and cash equivalents:			
At 1 January 2005	<u>6,930</u>	<u>7,466,103</u>	<u>7,473,033</u>
At 31 December 2005	<u>432,904</u>	<u>11,234,832</u>	<u>11,667,736</u>
<b>2004</b>			
Cash flows from:			
Operating activities	14,916,067	(29,149,285)	(14,233,218)
Investing activities	-	(1,980,279)	(1,980,279)
Financing activities	(15,000,000)	-	(15,000,000)
Net decrease in cash and cash equivalents	<u>(83,933)</u>	<u>(31,129,564)</u>	<u>(31,213,497)</u>
Cash and cash equivalents:			
At 1 January 2004	<u>90,863</u>	<u>38,595,667</u>	<u>38,686,530</u>
At 31 December 2004	<u>6,930</u>	<u>7,466,103</u>	<u>7,473,033</u>



## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### 19 RELATED PARTY DISCLOSURES

The Corporation is a subsidiary of American International Group, Inc., a corporation incorporated in the United States of America. In the normal course of business, the Corporation's operations in Malaysia undertake at agreed terms and prices, various transactions with the holding corporation and other related corporations deemed related parties by virtue of them being members of American International Group, Inc. group of companies ("AIG Group").

(a) Details of significant transactions arising from normal business transactions during the financial year between the Corporation's operations in Malaysia and AIG Group are as follows:

	<b>2005</b>	<b>2004</b>
	<b>RM</b>	<b>RM</b>
Premiums received	546,658	508,717
Inward reinsurance premiums received	975,825	753,472
Reinsurance premiums ceded	(109,778,040)	(113,904,664)
Claims paid	(102,563)	(138,000)
Reinsurance claims recoveries	28,066,061	23,858,874
Commissions paid	-	(46,222)
Commissions earned	23,318,969	22,764,936
Rental and utilities paid to a related corporation	(4,511,025)	(4,126,380)
System related costs paid to related corporations	(3,379,742)	(2,532,847)
Personnel and related costs received from a related corporation	313,970	225,968
Claims handling fee received from related corporations	221,303	230,510

(b) The related party balances as at the date of the statement of assets and liabilities are included in the following notes to the financial statements:

	<b>2005</b>	<b>2004</b>
	<b>RM</b>	<b>RM</b>
<b>Receivables (Note 6)</b>		
Due from reinsurers and cedants	727,332	932,420
Amount due from related corporations	1,276,101	690,742
<b>Payables (Note 9)</b>		
Due to reinsurers and cedants	3,731,219	14,634,749

## NOTES TO THE FINANCIAL STATEMENTS

– 31 DECEMBER 2005 (CONTINUED)

### 20 FINANCIAL INSTRUMENTS

#### Financial risk management objectives and policies

##### **Investment risk**

Generally, insurance regulations restrict the types of assets in which an insurance company may invest. Investment risk represents the exposure to loss resulting from the cash flows from the invested assets, primarily long-term fixed rate investments, being less than the cash flows required to meet the obligations of the expected policy and contract liabilities and the necessary returns on investments.

The Branch makes moderate to long-term investments primarily in Malaysian Government Securities and investment graded corporate bonds to support the general insurance policy liabilities.

To minimise its exposure to investment risk, the Branch adopts fundamental research and active management to seek a balanced portfolio to meet the investment objectives for income, security of principal and diversification in terms of size, issuers and types of industry.

##### **Equity price risk**

The Branch currently maintains low exposure to listed equity securities at less than 10% of its total portfolio to limit its equity price risk.

##### **Interest rate risk**

The Branch's investment activities are inherently exposed to interest rate risk which arises principally from differences in maturity or re-pricing of invested assets. In dealing with this risk, the Branch adopts an approach of focusing on achieving a desired overall interest rate profile, which may change over time, based on management's longer term view of interest rates and economic conditions.

##### **Liquidity risk**

Liquidity risk is the risk that the Branch cannot meet its financial liabilities when due. Liquidity risk is managed both at corporate level and local level. The Branch's liquidity is primarily derived from the operating cash flows which are derived from two sources i.e. underwriting operations and investment operations.

AIG's strong capital position is integral to managing this liquidity, as it enables AIG to raise funds in diverse markets worldwide. Management believes that AIG's liquid assets, its net cash provided by operations and access to the capital markets will enable it to meet any foreseeable cash requirements.

## NOTES TO THE FINANCIAL STATEMENTS

– 31 DECEMBER 2005 (CONTINUED)

### 20 FINANCIAL INSTRUMENTS *(Continued)*

#### **Business and operational risk**

Operational risks include legal, tax, political, regulatory, market conduct and business continuity risks.

These risks arise from the uncertainty of the enforceability through legal or judicial processes, of the obligations of the Branch's clients and counterparts. Internal Audit, supported by Legal and Compliance departments, review the effectiveness of internal controls on a regular basis.

#### **Underwriting and credit risk**

The Branch as part of AIG is a major purchaser of reinsurance. AIG is cognisant of the need to exercise good judgement in the selection and approval of companies participating in its reinsurance programs.

AIG's Reinsurance Security department, consisting of members of AIG's senior management, conducts ongoing detailed assessments of the reinsurance markets and current and potential reinsurers. Such assessments include, but are not limited to, identifying if a reinsurer is appropriately licensed, and has sufficient financial capacity, and the local economic environment. This department also reviews the nature of the risks ceded and the need for collateral. In addition, AIG's Credit Risk Committee reviews the credit limits and concentrations with any one reinsurer. No single reinsurer is a material reinsurer on AIG nor is AIG's business substantially dependent upon any reinsurance contract.

In the ordinary course of business, the Branch cedes reinsurance to other insurance companies in order to provide greater diversification of its business and limit the potential losses arising from large risks.

The Branch's reinsurance arrangements do not relieve it from its direct obligations to its insureds. Thus, a credit exposure exists with respect to general reinsurance ceded to the extent that any reinsurer is unable to meet the obligations assumed under the reinsurance agreements. The Branch manages its credit risk in its reinsurance relationships by transacting with reinsurers that it considers financially sound.

## NOTES TO THE FINANCIAL STATEMENTS

– 31 DECEMBER 2005 (CONTINUED)

### 20 FINANCIAL INSTRUMENTS (Continued)

#### Weighted average effective interest rates and maturity dates

The following table summarises the composition of the Branch's weighted average effective interest rate and the maturity date for each class of interest-bearing financial instrument in the statement of assets and liabilities:

	<u>Interest-bearing: Contractual repricing or maturity date (whichever is earlier)</u>				Total carrying value RM	Weighted average effective interest rate %
	Non-interest bearing RM	1 year or less RM	1 to 5 years RM	More than 5 years RM		
<b>2005</b>						
Financial assets:						
Investments						
- Malaysian						
Government						
Securities	-	21,809,789	134,785,066	100,506,929	257,101,784	3.653
- Cagamas papers	-	35,188,629	14,999,107	-	50,187,736	2.999
- Corporate debt securities	-	-	20,482,720	84,385,276	104,867,996	5.256
- Equity securities of corporations	35,366,326	-	-	-	35,366,326	-
- Real estate investment trust	1,477,823	-	-	-	1,477,823	-
- Fixed deposits	-	23,580,840	16,704,586	85,000,000	125,285,426	4.714
- Other investments	220,000	-	-	-	220,000	-
Secured loans	-	-	-	8,295,454	8,295,454	8.250
Unsecured staff loans	23,947	80,605	622,634	5,210,554	5,937,740	4.930
Other receivables	11,010,999	-	-	-	11,010,999	-
Cash and bank balances	11,667,736	-	-	-	11,667,736	-
<b>Total financial assets</b>	<b>59,766,831</b>	<b>80,659,863</b>	<b>187,594,113</b>	<b>283,398,213</b>	<b>611,419,020</b>	
Other financial assets*					51,135,540	
<b>Total financial assets</b>					<b>662,554,560</b>	
Non-financial assets:						
Property, plant and equipment					13,606,345	
Deferred tax assets					5,670,000	
Assets held under Malaysian Motor Insurance Pool					2,470,398	
Other Receivables					333,022	
<b>Total assets per statement of assets and liabilities</b>					<b>684,634,325</b>	

## NOTES TO THE FINANCIAL STATEMENTS

– 31 DECEMBER 2005 (CONTINUED)

### 20 FINANCIAL INSTRUMENTS (Continued)

2005	Non-interest bearing RM	<u>Interest-bearing: Contractual repricing or maturity date (whichever is earlier)</u>			Total carrying value RM	Weighted average effective interest rate %
		1 year or less RM	1 to 5 years RM	More than 5 years RM		
Financial liabilities:						
Other payables	10,912,362	-	-	-	10,912,362	-
Other financial liabilities*					408,443,064	
Total financial liabilities					419,355,426	
Non-financial liabilities:						
Current tax liabilities					10,579,982	
Total liabilities per statement of assets and liabilities					429,935,408	

(\*Disclosure information for financial assets and liabilities that relates to rights and obligations arising under insurance contracts is not shown as it is excluded from the scope of FRS 132 “Financial Instruments: Disclosure and Presentation”.)

## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### 20 FINANCIAL INSTRUMENTS (Continued)

#### Weighted average effective interest rates and maturity dates (Continued)

The following table summarises the composition of the Branch's weighted average effective interest rate and the maturity date for each class of interest-bearing financial instrument in the statement of assets and liabilities:

	Non-interest bearing RM	<u>Interest-bearing: Contractual repricing or maturity date (whichever is earlier)</u>			Total carrying value RM	Weighted average effective interest rate %
		1 year or less RM	1 to 5 years RM	More than 5 years RM		
<b>2004</b>						
Financial assets:						
Investments						
- Malaysian						
Government						
Securities	-	-	198,141,738	42,478,097	240,619,835	3.505
- Cagamas papers	-	-	70,492,378	-	70,492,378	3.076
- Corporate debt						
securities	-	-	10,193,724	70,169,895	80,363,619	5.470
- Equity securities						
of corporations	22,692,963	-	-	-	22,692,963	-
- Fixed deposits	-	9,200,000	40,135,450	76,511,092	125,846,542	4.255
- Other investments	220,000	-	-	-	220,000	-
Secured loans	-	-	-	8,750,000	8,750,000	8.250
Unsecured staff						
loans	13,607	83,185	682,351	5,645,734	6,424,877	4.91
Other receivables	9,955,472	-	-	-	9,955,472	-
Cash and bank						
balances	7,473,033	-	-	-	7,473,033	-
Total financial assets	<u>40,355,075</u>	<u>9,283,185</u>	<u>319,645,641</u>	<u>203,554,818</u>	<u>572,838,719</u>	
Other financial assets*					<u>47,670,100</u>	
Total financial assets					620,508,819	
Non-financial assets:						
Property, plant and						
equipment					16,214,913	
Deferred tax assets					2,385,000	
Assets held under						
Malaysian Motor						
Insurance Pool					2,654,222	
Other Receivables					516,717	
Total assets per statement of assets and liabilities					<u>642,279,671</u>	

## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### 20 FINANCIAL INSTRUMENTS (Continued)

2004	Non-interest bearing RM	Interest-bearing: Contractual repricing or maturity date (whichever is earlier)			Total carrying value RM	Weighted average effective interest rate %
		1 year or less RM	1 to 5 years RM	More than 5 years RM		
Financial liabilities:						
Other payables	5,553,714	-	-	-	5,553,714	-
Other financial liabilities*					422,437,617	
Total financial liabilities					427,991,331	
Non-financial liabilities:						
Current tax liabilities					1,898,617	
Total liabilities per statement of assets and liabilities					429,889,948	

(\*Disclosure information for financial assets and liabilities that relates to rights and obligations arising under insurance contracts is not shown as it is excluded from the scope of FRS 132 "Financial Instruments: Disclosure and Presentation".)

## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### 20 FINANCIAL INSTRUMENTS (Continued)

#### Fair values

The carrying values of financial assets and liabilities of the Branch as at 31 December approximated their fair values, except for the following:

	<b>Carrying values 2005 RM</b>	<b>Fair values 2005 RM</b>
Investments:		
- Malaysian Government Securities	257,101,784	258,020,300
- Cagamas papers *	50,187,736	49,968,000
- Real estate investment trust	1,477,823	1,692,060
- Unquoted debt securities	104,867,996	108,006,800
Loans:		
- Unsecured staff loan **	5,937,740	4,899,620
- Secured loan	8,295,454	9,231,232
	<b>Carrying values 2004 RM</b>	<b>Fair values 2004 RM</b>
Investments:		
- Malaysian Government Securities	240,619,835	241,672,000
- Cagamas papers *	70,492,378	70,306,000
- Quoted equity securities of corporations	22,692,963	25,336,028
- Unquoted debt securities	80,363,619	81,893,200
Loans:		
- Unsecured staff loan	6,424,877	5,114,329
- Secured loan	8,750,000	9,779,232

\* The carrying value of investments in Cagamas papers at the statement of assets and liabilities date has not been written down to their fair value as the Management is of the opinion that these investments will be held for long-term purposes.

\*\* The carrying amount of the unsecured staff loan of the Branch was not reduced to its estimated fair value as the loan was staff loans to the employees of the Branch and the directors are of the opinion that the amount will be repaid in full on the due date.

#### Credit Risk

	<b>2005 RM</b>	<b>2004 RM</b>
Rating of corporate debt securities on market value basis		
AAA	31,665,000	31,617,000
AA	37,665,800	22,353,000
Not rated	38,676,000	27,922,500
	<u>108,006,800</u>	<u>81,893,200</u>

The rating categories are based on the grading of reputable rating agencies.



## NOTES TO THE FINANCIAL STATEMENTS

- 31 DECEMBER 2005 (CONTINUED)

### 21 COMMITMENTS

#### Non-cancellable operating lease commitments

As at the statement of assets and liabilities date, the Branch has rental commitments under non-cancellable operating leases:

	<b>Future minimum lease payments</b>	
	<b>2005</b>	<b>2004</b>
	<b>RM</b>	<b>RM</b>
<u>General and Shareholders' fund</u>		
Not later than 1 year	4,535,425	4,447,911
Later than 1 year and not later than 5 years	2,177,398	6,711,495
	<u>6,712,823</u>	<u>11,159,406</u>