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Australia's First Bank

International Financial Reporting Standards (IFRS)

Banking & Financial Services Law & Practice Conference

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Contents

- How is A-IFRS being implemented?
- Key accounting changes
- Business impacts
- Customer impacts

How is A-IFRS being implemented

- Projects established
- General approach
  - Assessment & planning
  - Design
  - Implementation

Contents

- How is A-IFRS being implemented
- Key accounting changes
- Business impacts
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Transition policy elections

- Restatement of previous business combinations
- Defined benefit superannuation funds
- Equity based remuneration - period of restatement
- Resetting the carrying value of sites and premises
- Financial instruments / insurance comparatives

Amortisation of goodwill & intangibles

Key differences

- Regular amortisation of goodwill ceases
- Carrying value of goodwill will be fixed the balance date (30 June or September 2004) subject to impairment
- Specific impairment testing rules
- Internally generated intangibles are prohibited
- Transfer of capitalised software from fixed assets to intangibles

Profit and loss after tax: increased
Total equity: increased on transition
Regulatory capital: $nil

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Business combinations

- Restructuring provisions more difficult to raise
- Contingent liabilities required to be recognised
- Increased recognition of non-goodwill intangibles
  - Contracts (e.g. servicing contracts)
  - Customer lists
  - Computer software
- All financial instruments to be recognised at fair value (even if subsequently accounted for on a different basis)
- Defined impairment tests

Effective yield

Key differences

- Interest recognised on effective yield basis
- Fees and direct costs associated with loan origination included in interest income as part of effective yield
- Incremental origination costs included in interest income

Profit and loss after tax: increased or decreased
Total equity: increased or decreased
Regulatory capital: increased or decreased

Effective yield

- Example

Loan	$100,000
Bullet repayment	5 years
Fixed Interest Rate	5.00%
Fees Received	$ 800
Directly Incremental Costs	$ 1,300
Effective Interest Rate	4.88%

Year	Contractual Balance	Carrying Amount	Deferred Income / Expense	A GAAP / Cash Interest	AIFRS Interest
1	100,000	100,500	500	5,000	4,909
2	100,000	100,409	409	5,000	4,905
3	100,000	100,314	314	5,000	4,900
4	100,000	100,214	214	5,000	4,895
5	100,000	100,109	109	5,000	4,890

Credit provisioning

Key differences

- Move to incurred loss model rather than expected loss model
- "Emergence period" requires provision for incurred but not yet identified losses
- Significant area of focus for banks
- Only specific and incurred provisions (no general component)
- Discount impaired assets using the original effective interest rate to determine provisions
- Interest is always recognised on impaired assets

Revenue recognition

- Credit card fees to be recognised over life of service
- Lending fees to be included on effective yield
- Guarantee fees recognised over period of risk
- Interest recognised on impaired loans
- Lease income / expense recognition

Accounting for tax

- Minimal impact on current income tax liability
- Required to use balance sheet approach for deferred tax
- Amounts impacted by management intentions (if plan to sell an asset)
- Recognition of new deferred tax amounts
- Timing and permanent differences replaced by temporary differences

Defined benefit superannuation

Key differences

- Recognition of surplus or deficit
- Choice of three approaches
- Transition adjustment for actuarial gains and losses
- Different measurement approaches

Consolidation of SPVs

Key differences

- Stricter interpretation - residual risk
- SPVs to be consolidated - mortgage securitisation & conduit vehicles
  - Assets and liabilities to increase
  - Most existing off balance sheet deals will be back on balance sheet

Derecognition

- Complex rules apply for any transaction other than a clean sale
- Pass through tests introduced
- Consider expected risks and rewards both pre and post any transaction
- Has "control" been transferred?

Hedge accounting

Key differences

- All derivatives to be shown at fair value in balance sheet
- Hedge ineffectiveness reported through profit and loss account
- Strict rules on hedge documentation / effectiveness testing
- Some derivatives no longer achieve hedge accounting
- Major change for Treasury activities
- Not all hedges of economic risks can be hedge accounted

Hedge accounting

- Types of hedges
  - Fair value hedges
    - Hedging instrument at fair value via the P&L
    - Hedged item fair valued for hedged variables only
  - Cash flow hedges
    - Hedging instrument at fair value via equity (initially)
    - Underlying not fair valued
    - Recognition of hedge result in P&L at time the underlying impacts P&L
  - Hedges of net investments
    - Consistent with current AGAAP treatment

Hybrid equity instruments

Key differences

- Instruments with a contractual obligation to pay interest or principal as cash or equivalent must be classified as debt
- Distributions on deals reclassified as debt treated as interest
- Regulatory impact (APRA) still uncertain

Equity based remuneration

Key differences

- Value of equity based remuneration to be expensed through profit and loss rather than disclosed in notes to accounts
- Tax impacts/changes

Profit and loss after tax: decreased
Total equity: $nil
Regulatory capital: $nil

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Business impacts

- External view
- Capital ratios/regulatory reporting
- Value management, including key financial measures
- Taxation impacts
- Audit implications

External View

- Investor view & understanding
- Communication to investors

Capital ratios

- APRA released first part of regulatory approach in February
- Part II - securitisation/hybrid capital due shortly
- IFRS impacts different across banks - some implications likely
- Transition period
- One-off capital adjustments
- Capital volatility

Value management

- All value management reward schemes need to be reviewed for impact of IFRS
- NPAT earnings numbers change under IFRS
- Comparative IFRS numbers may not be directly comparable
- Effective yield moves costs to revenue line and changes amortisation profile
- Possibility of revenue being earned again
- Consider whether rewards follow accounting

Taxation impacts

- IFRS changes impact calculation of thin capitalisation ratios, however transition period provided
- Share capital account tainting
- Impact on taxation of financial arrangements (TOFA)

Audit implications

- Extra audit costs for
  - Opening balance sheet
  - Opening AASB 132/139 balance sheet
  - Comparatives in first full year
- Stress in audit firms (availability of accountants)

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Customer impacts

- Customers also need to comply with IFRS
- Reviewing and changing credit processes
- Working with customers to optimise hedging

Questions?

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