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Asia Pacific Dbriefs Presents:

Global Financial Reporting.

IFRS: Important Developments

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Agenda

- Updated IASB work plan
- IFRS developments
- Financial instruments project update
- Questions & Answers

Keep in mind

This webcast does not provide official Deloitte Touche Tohmatsu Limited interpretive accounting guidance

Check with a qualified advisor before taking any action

Learning objective

To enhance participants' understanding of important accounting issues and developments pertaining to recent actions of the IASB

Updated IASB work plan

Updated IASB work plan

Project	Exposure draft / review draft	Final standard
Financial instruments		
• General hedging	Q1 2012	Q2 2012
• Impairment	Q2 2012	?
• Macro hedging	Q3 2012	?
Insurance contracts	Q2 2012	2013
Leases	Q2 2012	2013
Revenue recognition	Q4 2011	2013
Consolidation – investment entities	Q3 2011	?
Agenda consultation	Q3 2011	2012 (agenda decision)

IFRS developments

IFRS developments

- Revenue recognition
  - Comment period ends on 13 March 2012
  - Boards are performing outreach activities on new model
  - Re-deliberations expected to commence in second quarter
- Leases
  - New lessee and lessor models developed
    - Operating leases would be eliminated
    - Receivable and residual approach for lessors
  - Significant open issue remains on lessee model
    - One versus two models for pattern of expense recognition

IFRS developments (cont'd)

- Insurance
  - Progress has been made but areas of non-convergence exist
  - Boards will need to decide how to best move forward
- Consolidation – investment entities
  - Comment period on exposure draft ended on 5 January 2012
  - Investments held by investment entities measured at fair value
  - Areas of non-convergence exist
- Other projects
  - Amendment to IFRS 1 for government loans
  - Clarification of transition guidance for IFRS 10

Polling question 1

What is a reasonable period of time for adoption of the new standards relating to the convergence projects if comparative periods must be restated?

- 1 year
- 2 years
- 3 years
- 4 years
- Don't know / not applicable

Financial instruments project update

Accounting change timeline

Current expectation of future developments

		2007 to Q3 2010	Q4 2010	H1 2011	Q3 2011	Q4 2011	Q1 2012	Q2 2012	Q3 2012	2013/4	2015
IFRS 9	Phase I: classification & measurement of financial assets	Final standard phase I assets	Final standard phase I liabilities								Effective date 1 January 2015
	Phase I: classification & measurement of financial liabilities	Exposure draft									
	Phase II: impairment	Exposure draft		Supp-lementary document				Target exposure draft			
	Phase III: general hedge accounting		Exposure draft				Review draft	Target IFRS			
	Phase III: macro hedge accounting								Target exposure draft		
	Asset & liability offsetting			Exposure draft		Final standard					

TODAY

IFRS 9 effective date changed

IFRS 9 amended in December 2011

Old	New
Annual periods beginning on or after 1 January 2013 **Comparatives must be restated except if early adopt before 1 January 2012**	**Annual periods beginning on or after 1 January 2015** **Comparatives not required to be restated but new disclosures instead**

If adopt

- Before 1 January 2012 – need not restate comparatives
- After 1 January 2012 but before 1 January 2013 – must either (i) restate comparatives or (ii) not restate comparative but provide new disclosures
- After 1 January 2013 – need not restate comparatives but must provide new disclosures

New transitional disclosures show change in classification of financial assets and liabilities from IAS 39 to IFRS 9

New transitional disclosures

Reconciliation of statement of financial position balances from IAS 39 to IFRS 9 at 1 January 2015

Financial assets	**(i)**	**(ii)**	**(iii)**	**(iv) = (i) + (ii) + (iii)**	**(v) = (iii)**
	IAS 39 carrying amount 31 December 2014 (1)	**Reclassifications**	**Remeasurements**	**IFRS 9 carrying amount 1 January 2015**	**Retained earnings effect on 1 January 2015 (2)**
Measurement category:					
Fair value through profit or loss					
Additions:					
From available for sale (IAS 39)		(a)			(c)
From amortised cost (IAS 39) –required reclassification		(b)			
From amortised cost (IAS 39) –fair value option elected at 1 January 2015					
Subtractions:					
To amortised cost (IFRS 9)					
Total change to fair value through profit or loss					
Fair value through other comprehensive income					
Additions:					
From fair value through profit or loss (fair value option under IAS 39)–fair value through other comprehensive income elected at 1 January 2015					
From cost (IAS 39)					
Subtractions:					
Available for sale (IAS 39) to fair value through profit or loss (IFRS 9)					(d)
Available for sale (IAS 39) to amortised cost (IFRS 9)					(e)
Total change to fair value through other comprehensive income					

continued...

Source: IFRS Foundation

New transitional disclosures (cont'd)

...continued

Reconciliation of statement of financial position balances from IAS 39 to IFRS 9 at 1 January 2015

Financial assets	(i)	(ii)	(iii)	(iv) = (i) + (ii) + (iii)	(v) = (iii)
	IAS 39 carrying amount 31 December 2014 (1)	Reclassifications	Remeasurements	IFRS 9 carrying amount 1 January 2015	Retained earnings effect on 1 January 2015 (2)
Amortised cost					
Additions:					
From available for sale (IAS 39)					(f)
From fair value through profit or loss (IAS 39)–required reclassification					
From fair value through profit or loss (IAS 39)–fair value option revoked at 1 January 2015					
Subtractions:					
To fair value through profit or loss (IFRS 9) –required reclassification					
To fair value through profit or loss (IFRS 9) –fair value option elected at 1 January 2015					
Total change to amortised cost					
Total financial asset balances, reclassifications and remeasurements at 1 January 2015	(i)	Total (ii) = 0	(iii)	(iv) = (i) + (ii) + (iii)	

(1) Includes the effect of reclassifying hybrid instruments that were bifurcated under IAS 39 with host contract components of (a), which had associated embedded derivatives with a fair value of X at 31 December 2014, and (b), which had associated embedded derivatives with a fair value of Y at 31 December 2014.

(2) Includes (c), (d), (e) and (f), which are amounts reclassified from other comprehensive income to retained earnings at the date of initial application.

continued...

Source: IFRS Foundation

Classification and measurement reminder

Classification and measurement of assets

Two measurement categories

Business model test

Objective of entity's business model is to hold financial asset in order to collect contractual cash flows

Contractual cash flow characteristics

Contractual terms give rise solely to principal and interest on principal

→ **Amortized cost (only debt instruments)**

FVO for accounting mismatch

All other instruments

- Equity investments
- Derivatives
- Complex hybrids

→ **Fair value measurement**

Equities: OCI presentation available

Classification and measurement of assets

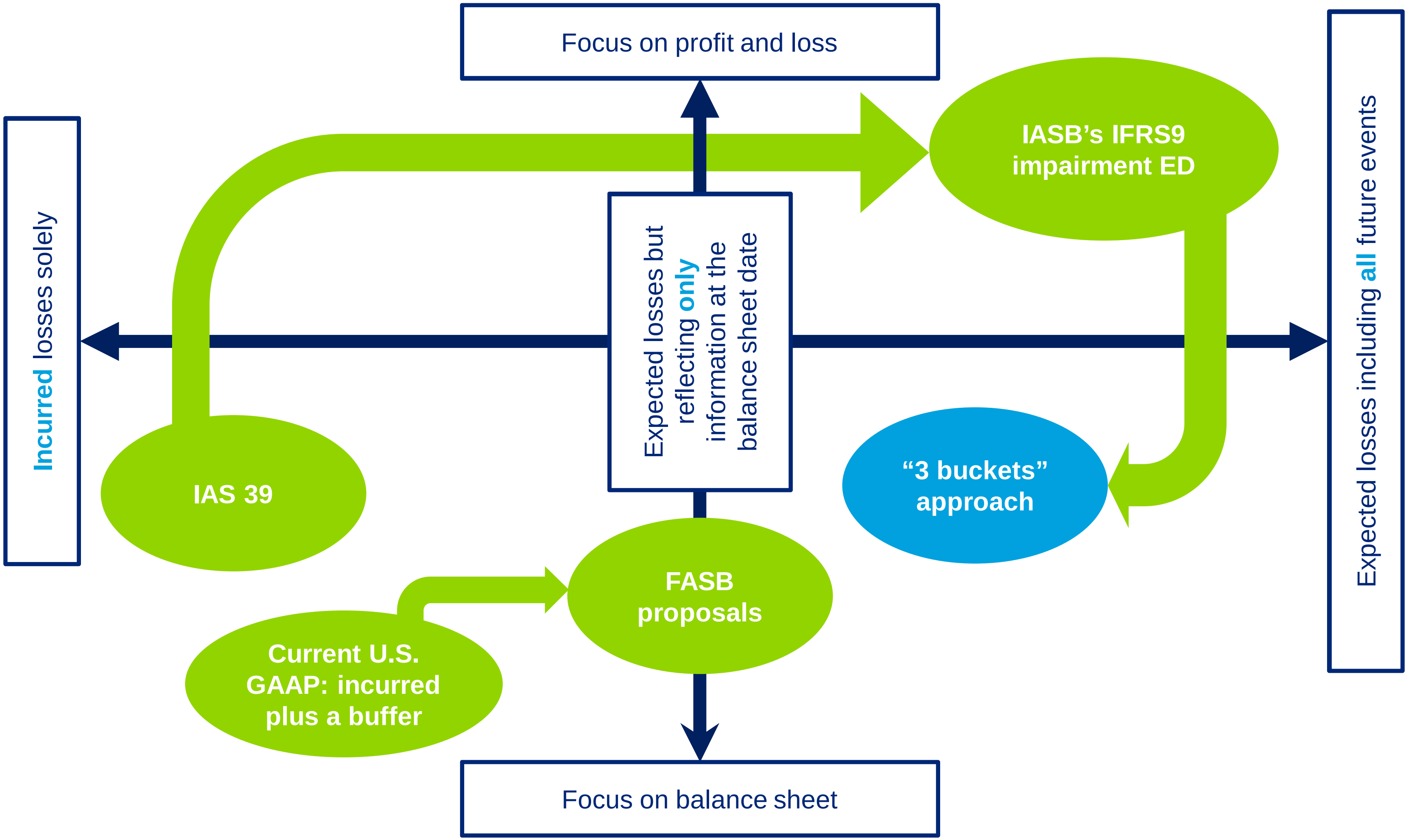
Reopening IFRS 9?

- IASB agreed by a slim majority in December 2011 to reconsider certain aspects of IFRS 9
- IASB will consider
  a) Whether to provide additional application guidance on the contractual cash flows test
  b) Following (a) consider whether to reintroduce bifurcation of embedded derivatives of financial assets
  c) Whether to expand the use of OCI or a third business model for some debt instruments

Impairment

Impairment reforms

Different theories



Impairment reforms
The three bucket approach

Bucket 1	Bucket 2	Bucket 3
• For assets not in bucket 2 or 3 • All financial assets start in bucket 1 at initial recognition • The latest thinking is for the loan loss provision to represent expected losses for the next 12 months from the balance sheet date (i.e., 12-month PD x LGD x EAD)	• Move from bucket 1 to bucket 2 when there "is a more than insignificant deterioration in credit quality since initial recognition and the likelihood of default is such that it is at least reasonably possible that the contractual cash flows may not be recoverable" • The full lifetime expected credit losses would be recognized, calculated on an **grouped asset basis**	• For individual assets where information is available that specifically identifies that credit losses have occurred or are expected to occur for individual assets • The full lifetime expected credit losses would be recognized, calculated on an **individual asset basis**
Provide for 12-month expected losses	Provide for lifetime expected losses	

- Model applies equally to loans and debt securities
- Theoretically – subject to materiality – all loans and debt securities will have a bucket 1 provision

Hedge accounting

Hedge accounting reforms

Overview

General hedge accounting model

- **Deliberations complete**
- **Review draft to be issued imminently**
- **Final standard expected Q2 2012**

Macro hedge accounting model

- Deliberations ongoing but in their infancy
- Exposure draft planned for Q3 2012

General hedge accounting model

Closer alignment with risk management

Key areas of change

- Increased eligibility of **hedged items**
- Increased eligibility of **hedging instruments**
- New qualification **effectiveness** requirements
- Increased **disclosures**

Hedged items

More exposures eligible for hedge accounting

Hedged items

- **Risk components**
  - Risk components of non-financial items
  - Inflation component
  - Credit risk component
  - Layer component
- **Synthetic hedged items**
  - Combinations of derivatives and exposures
  - Synthetic position need not be in a hedge relationship
- **Groups and net positions**
  - Cash flow hedges of FX risk only
  - Fair value hedges
- **FVTOCI equity investments**
  - Hedge ineffectiveness recognized in OCI

Hedging instruments
Reduced volatility from hedging instruments

Hedging instruments

Financial options
- Changes in time value of options recognized in OCI
- “Transaction” related hedged items
- “Period” related hedged items

Forward contracts
- Forward points deferred in OCI when hedge spot
- Forward points amortized from OCI to P/L
- Choice for each hedge relationship

Non-derivative instruments
- If FVTPL, then can hedge any eligible hedged risk

Written options
- Combinations can include separate written options (provided not net written option)

Qualifying for hedge accounting

Hedge effectiveness requirements

Economic relationship

- Values generally move in opposite direction

- Qualitative vs. quantitative assessment

Credit risk not dominate

- Credit risk can negate economic relationship

Hedge ratio

- Cannot create hedge ineffectiveness (i.e., base on actual ratio)

- **Rebalancing** of hedge ratio may be required

Hedge accounting disclosures

Increased transparency

Risk management strategy	• Disclosures on hedging risk components • How economic relationship determined • How hedge ratio determined
Effect on cash flows	• Quantitative information about hedging instruments • Sources of hedge ineffectiveness by risk
Effect on financial statements	• Quantitative disclosures of amounts arising from hedge accounting (including line item location) • Examples: hedge ineffectiveness; amounts deferred in OCI; amounts reclassified from OCI; amounts related to time value of options and forward points of forwards

Hedge accounting reforms
Overview

General hedge accounting model

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Macro hedge accounting model

Risk management perspective

The economic problem

- Lenders hold a mixture of fixed rate and floating rate assets and liabilities which gives rise to
  - Variability in earnings (e.g., net interest margin)
  - Variability in economic value (e.g., fair value)
- Lenders manage these risks within specific limits
- These risks are competing (e.g., fully hedging economic value gives rise to variability in earnings and vice versa)
- Common measures include: gap analysis, earnings at risk, value at risk and duration

The risk management solution

- Derivatives (e.g., IRSs, CCIRSs, Options, Futures, etc.) are used to manage earnings and value within limits

Macro hedge accounting model
Accounting perspective

The purpose of hedge accounting
• To address the mismatch between accrual accounting for the hedged financial assets / liabilities and fair value accounting for the derivatives

Complications in reflecting risk management in accounting
• Lenders hedge on a portfolio basis not one-to-one basis (i.e., no tracking of individual items) • Lenders hedge risk on a net basis • Lenders do not distinguish between derivatives and cash instruments when measuring and hedging the net risk • Lenders hedge their balance sheet based on behavioral, not contractual, profile (e.g., demand deposits have longer behavioral life, prepayments are modeled, pipeline is forecast, etc.) • Lenders use internal derivatives to transfer risk • Lenders retain and trade interest rate risk in their trading book • Hedging transactions are executed on a daily basis • International banks may hedge interest rate and FX risk in combination

Offsetting financial assets and financial liabilities

Financial asset and financial liability offsetting
Amendments to IAS 32 & IFRS 7

- IAS 32 amendments (effective 1 January **2014**)
  - Clarify current IAS 32 requirements
    - **Current legally enforceable right to set-off the recognized amounts** must not be contingent on a future event and must apply in normal course of business, default / insolvency / bankruptcy, for the entity and all counterparties
    - **Simultaneous settlement** is acceptable with a gross settlement system subject to meeting specified criteria (particular relevant for clearing houses)
  - Reminder, offset is **required** if the criteria are met
- Not converged with U.S. GAAP, particularly with contingent rights of set-off

Financial asset and financial liability offsetting

Amendments to IAS 32 & IFRS 7 (cont'd)

- IFRS 7 amendments (effective 1 January **2013**)
  - Far more extensive disclosures where financial instruments are subject to "an enforceable master netting arrangement or similar agreement"
  - Aim for disclosures to converge with U.S. GAAP
  - Tabular quantitative disclosures showing
    - Gross exposures
    - Less amount set off in accordance with IAS 32
    - Net exposures per the statement of financial position [(a) less (b)]
    - Less amounts subject to master netting agreement (including collateral whether recognized or not)
    - Net exposures [(c) less (d)]

Financial asset and financial liability offsetting

Amendments to IAS 32 & IFRS 7 (cont'd)

IFRS 7 amendments illustrated

Financial assets subject to offsetting, enforceable master netting arrangements and similar agreements

CU million

As at 31 December 20XX	(a)	(b)	(c)=(a)-(b)	(d)		(e)=(c)-(d)
				Related amounts not set off in the statement of financial position		
	Gross amounts of recognised financial assets	Gross amounts of recognised financial liabilities set off in the statement of financial position	Net amounts of financial assets presented in the statement of financial position	(d)(i), (d)(ii) Financial instruments	(d)(ii) Cash collateral received	Net amount
Description						
Derivatives	200	(80)	120	(80)	(30)	10
Reverse repurchase, securities borrowing and similar agreements	90	-	90	(90)	-	-
Other financial instruments	-	-	-	-	-	-
Total	290	(80)	210	(170)	(30)	10

Financial liabilities subject to offsetting, enforceable master netting arrangements and similar agreements

CU million

As at 31 December 20XX	(a)	(b)	(c)=(a)-(b)	(d)		(e)=(c)-(d)
				Related amounts not set off in the statement of financial position		
	Gross amounts of recognised financial liabilities	Gross amounts of recognised financial assets set off in the statement of financial position	Net amounts of financial liabilities presented in the statement of financial position	(d)(i), (d)(ii) Financial instruments	(d)(ii) Cash collateral pledged	Net amount
Description						
Derivatives	160	(80)	80	(80)	-	-
Repurchase, securities lending and similar agreements	80	-	80	(80)	-	-
Other financial instruments	-	-	-	-	-	-
Total	240	(80)	160	(160)	-	-

Source: IFRS Foundation

Polling question 2

Do you believe it is important for the IASB and FASB to issue identical standards for their convergence projects?

- Yes
- No
- Don't know / not applicable

Questions & Answers

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