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IFRS: Important Developments

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Agenda

- IFRS update
- Developments in the financial instruments project
- 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

Project	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013
Financial instruments					
• General hedging	~~Final Standard~~		Final Standard		
• Macro hedging		Discussion Paper			
• Impairment	~~Exposure Draft~~	Exposure Draft[1]			
• Classification and measurement[2]	Exposure Draft[3]		Redeliber-ations		
Insurance contracts		Exposure Draft			
Leases		~~Exposure Draft~~	Exposure Draft		
Revenue recognition		Final Standard			
Consolidation – investment entities	Final Standard[4]				
Rate-regulated activities					
• Interim IFRS			Exposure Draft		
• Comprehensive project			Info Request		Discussion Paper

[1] Issued 7 March 2013
[2] Limited amendments
[3] Issued 28 November 2012
[4] Issued 31 October 2012

Financial instruments project update

The IFRS 9 timeline

Are we there yet?

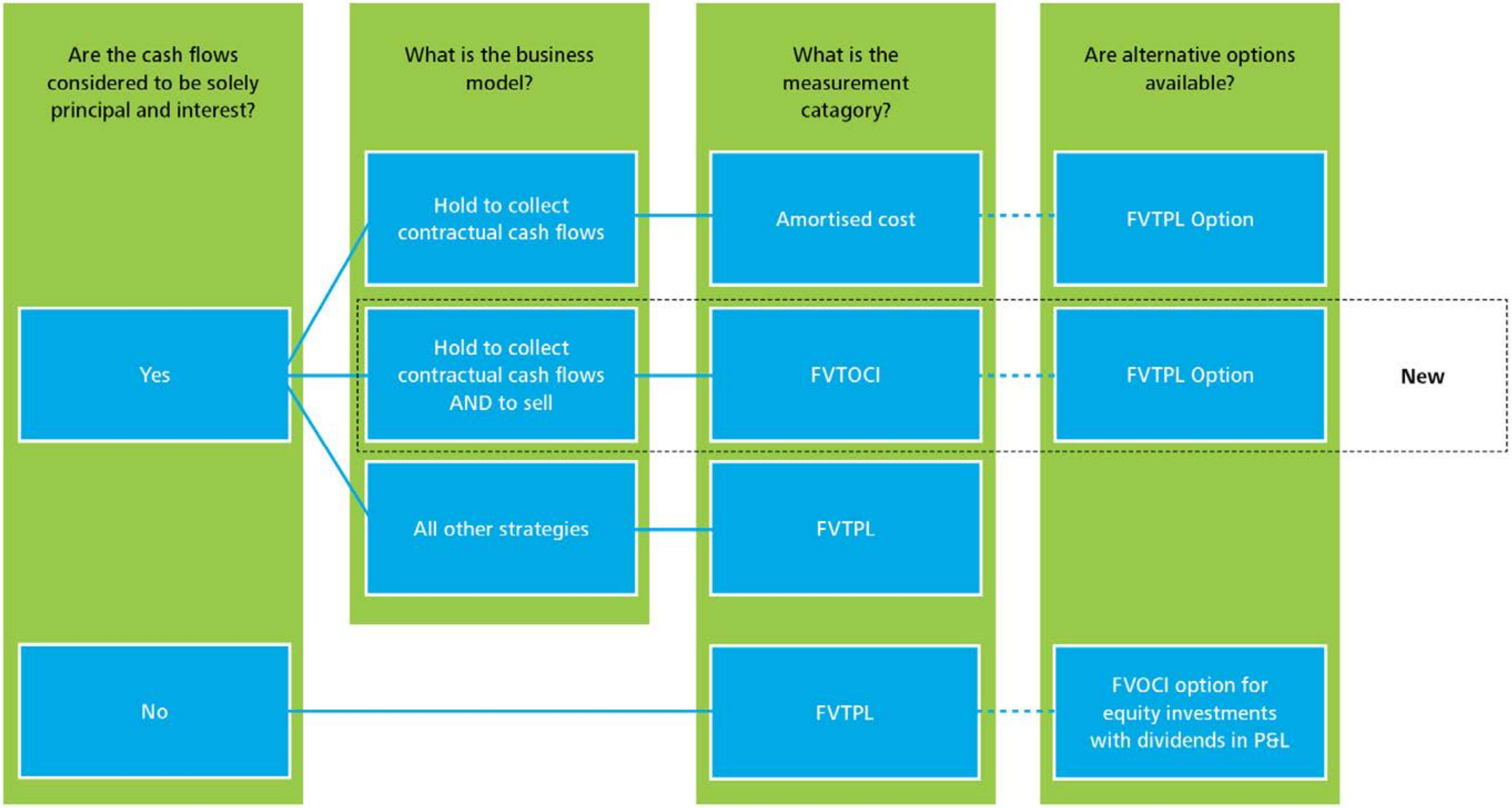
		2007 to Q3 2010	Q4 2010	H1 2011	H2 2011	H1 2012	H2 2012	H1 2013	H2 2013	2014	2015
IFRS 9	Phase I: Classification & Measurement of Financial Assets	Final Standard Phase 1 financial assets					Exposure draft for limited amendments		Expected final standard Phase 1 Financial assets and liabilities		Effective Date 1 January 2015
	Phase I: Classification & Measurement of Financial Liabilities	Exposure Draft	Final Standard Phase 1 financial liabilities								
	Phase II: Impairment	Exposure Draft		Sup Document				Exposure draft	Expected final standard		
	Phase III: General Hedge Accounting		Exposure Draft				Staff draft of forthcoming standard	Expected final standard			
	Phase III: Macro Hedge Accounting								Discussion paper		

Today

Phase 1: Classification and measurement

Classification and measurement

After the proposed amendments in the Exposure Draft (ED)



Classification and measurement

Other proposed amendments

- Contractual cash flow characteristics test
  - Change for instrument with “modified features”, e.g., a variable interest rate that doesn’t match the interest reset period
  - Cash flows are compared to a benchmark instrument
  - If differences are not more than insignificant the instrument will pass the contractual cash flow characteristics test
- Early adoption of requirements for liabilities
  - Entities will be able to early adopt of the “own credit” requirements alone once IFRS 9 is finalised

Polling question 1

What is the likelihood that your company would early adopt IFRS 9 (in full or in part)?

- Unlikely to early adopt
- Possibly early adopt
- Highly likely to early adopt or have already early adopted
- Not applicable (e.g., not an IFRS reporter)

Phase 2: Impairment

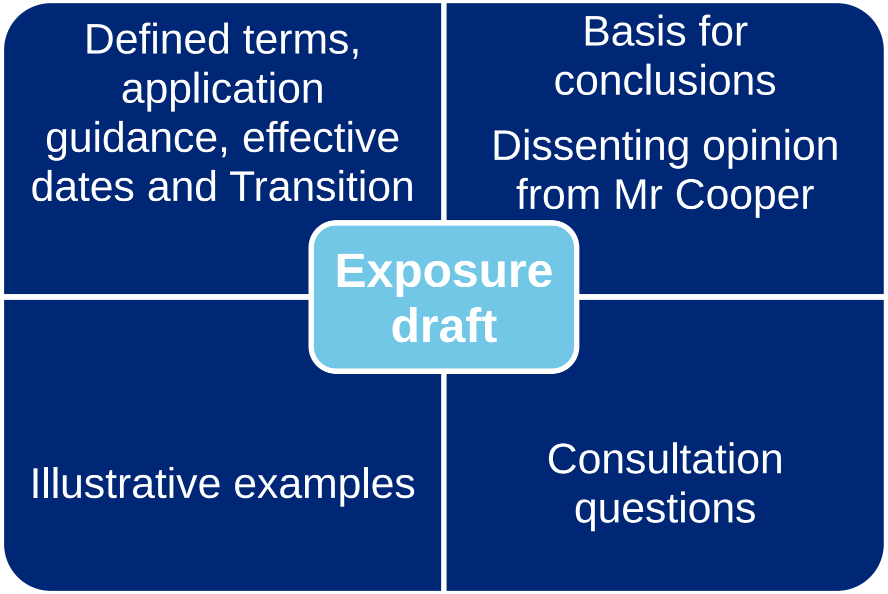
Phase 2: Impairment
Project history

Development of an **expected loss** model:

- **Exposure draft** Q4 2009 — Recognition of expected losses over life of instrument through effective interest rate (EIR)
- **Supplementary document** Q1 2011 — Assets split in to “good book” and “bad book”. Life time expected losses recognised for bad book assets
- **Exposure draft issued 7 March 2013 (120 day comment)** — Two buckets: 12 month expected losses and full life time expected losses

Exposure draft financial instruments: expected credit losses

- The objective of the draft standard “is to establish principles for the **recognition, measurement, presentation, and disclosure** of expected credit losses that will provide useful information for users of financial statements for their assessment of the amount, timing and uncertainty of future cash flows.”



Published 7 March 2013

Consultation period to 5 July

Scope

Financial assets at amortised cost under IFRS 9

…and at fair value through other comprehensive income

Loan commitments where an obligation to extend credit exists

Financial guarantee contracts (FGC)

Lease receivables

Expected credit losses

Two stages (buckets)

12 month expected losses

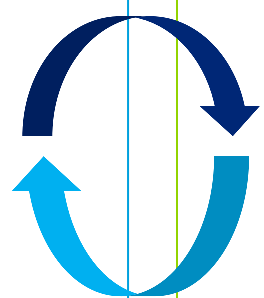
- All assets begin in this bucket, unless credit impaired on initial recognition
- 12 month expected losses are recognised as cash short falls expected over the full life of the asset due to possible default events in the 12 months after the reporting date (not cash short falls expected to occur over the next 12 months)

From full lifetime expected losses to 12 month expected losses if credit risk improves sufficiently

Full lifetime expected losses

- Assets migrate to this bucket if the credit risk has increased significantly since initial recognition
- Assets in this bucket have an allowance for full lifetime expected losses

From 12 month expected losses to full lifetime expected losses when credit risk increases significantly



Note: FASB approach only has this bucket

Significant increase in credit risk

- Assessment of a significant increase in credit risk based on
  - Significant increase in the probability of default since initial recognition
  - Generally, there is a significant increase in credit risk before a default occurs or before there is objective evidence of impairment
  - The probability of default is higher the longer the remaining life of the instrument, therefore the change in credit risk cannot be assessed simply by comparing change in absolute probability of default over time
  - The significance of a change in credit risk depends on the probability of default occurring at initial recognition. A change in absolute terms is more significant for an instrument with a lower probability of default
  - An individual instrument basis, although a collective basis is acceptable where financial instruments share the same risk characteristics
  - Rebuttable presumption that significant increase in credit risk occurs when contractual payments are more than 30 days past due

Exception if credit risk is low. For example, instrument is equivalent to “investment grade” credit rating

Expected credit losses

Key features

ED

Basis for estimating expected cash flows

- Full probability weighted expected cash flows even for an individual asset; most likely outcome in terms of losses not allowed

Discount rate for expected losses

- Financial assets – reasonable rate (between risk free rate and effective interest rate)
- Loan commitments and financial guarantees – rate that reflects current market rates specific to instrument

Interest revenue

- **Gross basis** if non-credit impaired (EIR applied to gross carrying amount)
- **Net basis** if credit impaired (EIR applied to gross carrying amount less allowance)

Purchased credit impaired assets

- Different treatment for purchased credit impaired assets
- On initial recognition EIR calculated on net carrying value

Presentation of interest revenue

Initial recognition (non-credit impaired)	Significant increase in credit risk	Incurred loss
Allowance • 12-month expected losses **Interest revenue** • Effective interest on gross carrying amount	**Allowance** • Lifetime expected losses **Interest revenue** • Effective interest on gross carrying amount	**Allowance** • Lifetime expected losses **Interest revenue** • Effective interest on net amortised cost carrying amount

Measurement

Loan commitments and FGC contracts

Accounting for revenue from loan commitments and FGC contracts unchanged

- Recognise expected losses when there is a present legal obligation to extend credit
- When estimating expected losses consider

Usage behaviour

Maximum contractual exposure period

- Discount rate applied shall reflect
  - The risk free rate; and
  - Risks specific to the cash flows (if cash flows not adjusted for those risks)

Measurement

Trade receivables and lease receivables

Loss allowance = lifetime expected losses

- **Compulsory for**
  - Trade receivables without a significant financing component (a provision matrix could be used to estimate expected credit losses as a practical expedient)
- **Optional for**
  - Trade receivables with a significant financing component; and
  - Lease receivables
- Reduces complexity because an entity would not be required to track credit deterioration

Note: the revenue and leasing projects are on-going

Disclosure

- Amounts arising from expected credit losses
  - Reconciliation for gross carrying amount and loss allowance
  - Inputs and assumptions used to measure 12-month and lifetime expected credit losses
  - Write-offs; modifications; collateral
- Effect of the deterioration and improvement in the credit risk of financial instruments
  - Carrying amount by credit risk rating grades
  - Inputs and assumptions used in determining whether a significant increase in credit risk has occurred
  - Carrying amount of assets evaluated on individual basis

Effective date and transition

- Effective date will be established after comments have been considered
- IFRS 9 effective date is January 2015, with earlier adoption permitted
- Requirements will apply retrospectively under IAS 8, except restatement of prior periods not required
- If determining credit risk on initial recognition is difficult, loss allowance (i.e., 12 months or lifetime) based on level of risk at reporting date, not whether there has been an increase

Polling question 2

What is the likelihood that your company would take the practical expedient and recognise an allowance for lifetime expected losses for all trade receivables with a financing component (i.e., longer term) and / or all lease receivables?

- Unlikely to take practical expedient
- Possibly take the practical expedient
- Highly likely to take the practical expedient
- Not applicable (e.g., not an IFRS reporter)

Questions & Answers

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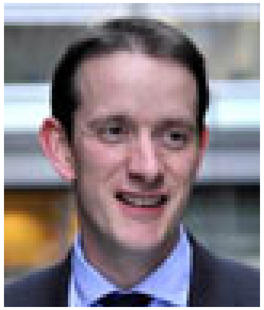
Speakers



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