IFRS changes impacting the banking industry

An update for the CFO
Second edition (May 2013)
Introduction

Financial institutions reporting under International Financial Reporting Standards (IFRSs) continue to face a steady flow of new standards and interpretations.

The IFRS changes range from minor modifications to significant amendments of fundamental principles. These changes will affect many different areas of financial reporting, including the introduction of extensive disclosure requirements, financial statements presentation, and how particular elements are recognised and measured.

The changes will also likely impact information systems and processes, as well as the regulatory capital of many banks. Furthermore, the changes may impact business decisions, such as which financial products to offer, the creation of joint arrangements or the structuring of particular transactions. The challenge for preparers will be to gain an understanding of the requirements, evaluate the implications, consider the timing of adoption, and plan for timely implementation of the changes.

This publication provides an overview of both finalised and forthcoming changes in standards, based on standard setting developments through 31 May 2013, that are of particular significance for banks. It is not intended to cover all changes to the IFRSs, nor does it attempt to provide an in-depth analysis or discussion of the topics. Rather, the objective is to highlight key aspects of these changes and the potential impacts. For a summary update on other topics not covered in this publication, refer to our general publications IFRS Update and IASB Projects: A Pocketbook Guide.¹

¹ Available at www.ey.com/ifrs
IFRSs applicable in 2013

This section provides a brief update on new standards and amendments to existing standards that are applicable from 1 January 2013 and that are of particular significance for financial institutions.

Fair value
In 2011, the IASB2 issued a new standard, IFRS 13 Fair Value Measurement, on how to measure fair value. The standard does not prescribe when to measure at fair value. Nor is the standard solely aimed at financial instruments, but rather it applies to all assets and liabilities that are required or permitted to be measured at fair value. It also applies to all disclosures of fair value. The new definition of fair value is based on an exit price notion (i.e., the price that would be received to sell an asset or paid to transfer a liability at the measurement date). The standard requires fair value measurements to maximise the use of observable inputs and minimise the use of unobservable inputs. The standard also requires entities to record an adjustment to the measurement of liabilities to reflect an entity’s own default risk. Furthermore, the standard provides a number of clarifications, including:

- Market participants are assumed to transact in a manner that maximises the value to them.
- Blockage discounts are prohibited in all fair value measurements.
- Guidance is provided on how to measure fair value when a market becomes less active.

Potential impact
The standard may, among other things, impact the way that financial institutions measure fair value for portfolios of derivatives with offsetting risks. The adjustment to reflect the ‘own’ credit risk entity, may potentially cause hedge ineffectiveness where derivatives are used for hedging purposes.

Furthermore, new disclosures related to fair value measurements have been introduced to help users understand the valuation techniques and inputs used to develop fair value measurements, and the effect of fair value measurements on profit or loss. The vast majority of the new disclosures will also be required to be provided in the interim financial statements.

Effective date and transition
IFRS 13 is effective for annual periods beginning on or after 1 January 2013. IFRS 13 applies prospectively.

Offsetting financial assets and financial liabilities — amendments to IFRS 7
The amendments to IFRS 7 Financial Instruments: Disclosures, which were issued by the IASB in December 2011, require an entity to disclose information about rights of set-off and related arrangements (e.g., collateral agreements). The information provided is considered useful for users of financial statements in evaluating the effect of netting arrangements on an entity’s financial position. The new disclosures are required for all recognised financial instruments that are set off in accordance with IAS 32 Financial Instruments: Presentation. The disclosures also apply to recognised financial instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are set off in accordance with IAS 32.

Potential impact
In order to extract the necessary data to prepare the new disclosures, entities (in particular, banks) may need to modify management information systems and internal controls, including linking their credit systems to accounting systems. Such modifications need to be executed as soon as possible in light of the 2013 mandatory effective date and the requirement to apply these disclosures retrospectively.

Effective date and transition
These amendments are effective for periods beginning on or after 1 January 2013 and must be applied retrospectively, in accordance with the requirements of IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors for changes in accounting policy.

Post-employment benefits
In 2011, the IASB issued amendments to IAS 19 Employee Benefits. The changes have the following major effects:

- Full balance-sheet recognition of actuarial gains and losses, with the optional ‘corridor’ deferral mechanism removed
- Actuarial gains and losses are now required to be recognised in other comprehensive income (OCI) and will be excluded permanently from earnings. Amounts recorded in profit or loss are limited to current and past service costs, gains and losses on settlements, and net interest income (expense)
- Expected returns on plan assets will no longer be recognised in profit or loss. Expected returns on plan assets, along with interest on the defined benefit obligation, are replaced by recording net interest in profit or loss, which is calculated using the discount rate used to measure the pension obligation
Unvested past service costs as a result of plan amendments or curtailments can no longer be deferred and recognised over any future vesting period.

The introduction of new and revised disclosure requirements

The IASB is currently working on a number of narrow scope amendments to IAS 19, including the discount rate to use for discounting employee benefit obligations. Refer to the Implementation Project section for further details.

Potential impact

The amendments may result in greater balance sheet volatility, particularly for those entities previously applying the corridor approach.

Net profit will no longer reflect expected return on plan assets and earnings for some entities may also be impacted by the requirements to recognised actuarial gains and losses in OCI.

Effective date and transition

These amendments are effective for annual periods beginning on or after 1 January 2013. Retrospective application is required with very limited exceptions.

Consolidation, joint ventures and related disclosures

In 2011, the IASB issued three new standards: IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interests in Other Entities.

IFRS 10 establishes a single control model that applies to all entities (including special purpose entities, or structured entities). The changes introduced by IFRS 10 will require management to exercise significant judgement in determining which entities are controlled, and, therefore, are required to be consolidated by a parent. In October 2012, the IASB issued an amendment to IFRS 10 to provide an exception to the consolidation requirement for entities that meet the definition of an investment entity. An investment entity is required to account for subsidiaries at fair value through profit or loss in accordance with IFRS 9 Financial Instruments.

Joint arrangements are now required to be classified as either joint ventures or joint operations as defined in IFRS 11. In joint operations, the joint operator will recognise its assets, liabilities, revenues and expenses and/or its share of those items, if any. In joint ventures, the venturer will now equity account for its interest in the joint venture. The option to account for joint ventures using proportionate consolidation has been removed.

IFRS 12 contains significant new disclosure requirements for both consolidated and certain unconsolidated entities, resulting in significant data challenges.

Potential impact

The most significant impact of IFRS 10 will likely be felt by the insurance and asset management arms of banks, entities with significant involvement in structured entities, and banks’ loan work-out departments. Key income statement and balance sheet metrics, as well as compliance with regulatory requirements, may be affected depending whether more or fewer entities are consolidated.

The standards bring operational challenges, both in scoping and implementation. Specific technical challenges continue to emerge, as banks work through the details of the standards, that will require robust technical analysis.

New processes and controls will be required for gathering the information for the substantial new disclosures related to structured entities required by IFRS 12.

Effective date and transition

IFRS 10, IFRS 11 and IFRS 12 are effective for annual periods beginning on or after 1 January 2013. Retrospective application is required with some relief from certain IAS 8 disclosure requirements. Early application is permitted, provided that an entity adopting IFRS 10 or IFRS 11 early, also applies the requirements of IFRS 12, IAS 27 Consolidated and Separate Financial Statements (as revised in 2011) and IAS 28 Investments in Associates (as revised in 2011) at the same time. The investment entity amendment is effective one year later than IFRS 10. Since early application is permitted, entities may elect to apply the investment entity amendment at the same time as it applies IFRS 10.

In Europe, the European Commission endorsed IFRS 10, IFRS 11, IFRS 12, IAS 27 (as revised in 2011) and IAS 28 (as revised in 2011) for use in the European Union with the effective date deferred to annual periods beginning on or after 1 January 2014, to allow entities more time for implementation.
IFRSs and future pronouncements applicable in 2014 or later

This section provides a brief update on new standards and amendments to existing standards that are applicable starting from 1 January 2014 and are of particular significance for financial institutions. It also provides a brief update on certain IASB projects that are relevant for financial institutions, some of which are expected to result in exposure drafts or final IFRSs by the end of 2013 or 2014.

Balance sheet offsetting
The IASB finished its project on balance sheet offsetting of financial instruments in December 2011 with the issue of amendments to IAS 32 and IFRS 7. The IASB decided to retain the existing offsetting criteria in IAS 32. In addition, it decided to amend some of the application guidance in IAS 32 to address inconsistencies in the interpretation of these criteria with respect to the meaning of “currently has a legally enforceable right to set-off” and the “simultaneous settlement” criterion. Currently, transactions settled through clearing systems are, in most cases, considered to achieve simultaneous settlement. While some settlement systems are expected to continue to provide eligibility for offsetting, some may not.

Potential impact
Entities may need to review their legal documentation and settlement procedures, including those applied by the central clearing houses they deal with to ensure that offsetting is still appropriate. Any changes in an entity’s ability to offset may impact leverage and regulatory capital ratios.

Effective date and transition
The revised offsetting rules are to be applied retrospectively in years commencing on or after 1 January 2014.

Levies charged by government entities in accordance with a legislation
In May 2013, the IASB issued IFRIC Interpretation 21 Levies, which was developed by the IFRS Interpretations Committee (the Committee). The interpretation clarifies that an entity recognises a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. It also clarifies that a levy liability is accrued progressively only if the activity that triggers payment occurs over a period of time, in accordance with the relevant legislation. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be recognised before the specified minimum threshold is reached.

Potential impact
For a bank that is obligated to pay a levy (calculated based on amounts in the statement of financial position at the end of the annual reporting period), only if it operated as a bank at the end of the annual reporting period, no obligation is recognised before the end of the annual reporting period, even if it is economically compelled to continue operating as a bank in the future. This is because the activity that triggers the payment of the levy is the entity operating as a bank at the end of the reporting period.

The interpretation will eliminate the current diversity in practice. However, its scope is very broad and covers all types of levies other than outflows that are within the scope of other standards (e.g., IAS 12 Income Taxes) and fines or other penalties for breaches of legislation. It will also include levies measured based on non-financial information. Financial institutions need to consider whether the interpretation would impact the treatment of levies in their financial statements.

Effective date and transition
The interpretation is applicable for annual periods beginning on or after 1 January 2014. Early application is permitted. Retrospective application of this interpretation is required.
Financial instruments: classification and measurement

This first part of IFRS 9 Financial Instruments (finalised in 2009) prescribes, among other things, the conditions under which a financial asset may be measured at amortised cost. Two tests need to be met for amortised cost measurement: the business model test and the contractual cash flow characteristics of the asset test. The second part was added later to include the classification and measurement requirements for financial liabilities. In December 2011, the IASB amended IFRS 9 to move the mandatory effective date to 1 January 2015. However, the IASB is likely to move back this date further.

In November 2012, the IASB published an exposure draft (ED) proposing limited amendments to the IFRS 9 classification and measurement model.

The key amendments proposed by the IASB include:

- The introduction of a fair value through other comprehensive income (FVOCI) measurement category for certain debt instruments. This category is designed to capture portfolios of plain vanilla loans or debt securities that are managed within a hold and sell business model. This new category would generally capture a portfolio where the entity intends to maintain a certain level of investment in the financial assets for a period of time, but may seek to maximise its return through opportunistic selling and reinvestment in higher yielding assets. This could include, for example, some liquidity management portfolios held by banks, as well as portfolios where an entity manages the assets with the objective of matching their duration with that of associated liabilities that have no fixed maturities (such as assets that back insurance liabilities).

The proposed classification and measurement model for financial assets

Following the proposal to introduce a FVOCI category, debt instruments (such as loans and debt securities) would be classified, based on their contractual characteristics and the business model within which they are held, into one of three measurement categories: amortised cost, FVOCI or at FVPL. The diagram below shows the new decision tree for financial assets under the proposals.
Further guidance on applying the business model test, particularly regarding the types of business activities and the frequency and nature of sales that would (and would not) be consistent with the ‘hold to collect’ business model in order to qualify for the amortised cost measurement category.

Permission to early apply the requirements in IFRS 9 regarding presentation in OCI of fair value changes attributable to own credit risk of non-derivative financial liabilities designated at fair value through profit or loss (FVPL), without having to adopt the rest of the standard.

**Potential impact**

IFRS 9, as it currently stands, changes the measurement and presentation of many financial instruments depending on their purpose and nature. For example, financial assets currently classified as available-for-sale or at FVPL may, based on their contractual characteristics and the business model within which they are held, be included in the amortised cost category.

These changes (from IAS 39 Financial Instruments: Recognition and Measurement) will determine whether and when amounts are recognised in net profit, for example:

- Increased profit and loss volatility is expected as more instruments are classified at fair value through profit or loss
- Own credit risk adjustments on financial liabilities designated as at fair value will no longer be reflected in profit or loss

The proposed introduction of the FVOCI category, along with clarifications to the application guidance on the business model test, is of particular significance for many banks in respect of their liquidity buffer portfolios held to fund unexpected cash outflows arising from stressed scenarios. Many such portfolios could now be required to be measured at FVOCI, considering the levels of asset turnover expected in them. Measurement at FVOCI could have a knock-on effect on regulatory capital given the removal of the available-for-sale filter under BASEL III. Banks and other regulated financial institutions may have to revisit their initial assessments of how the classification and measurements of IFRS 9 may apply to them.

**Convergence with US GAAP**

Whilst the joint deliberations between the IASB and FASB\(^3\) have resulted in common objectives for the business models underlying the three measurement categories, the proposed standards are expected to be only directionally converged. This is because the guidance on applying these objectives was not, until now, deliberated jointly. Differences in the application guidance may potentially result in different classification and measurement outcomes.

**Project timeline**

The IASB gave constituents 120 days to provide feedback on the new proposals. The comment period closed on 28 March 2013. The IASB will start deliberating any comments it receives on the proposals during the second quarter of 2013. In light of the timeline for the ED, we do not expect a final classification and measurement standard before the fourth quarter of 2013. This, in conjunction with the timeline for the impairment and insurance projects, will undoubtedly put pressure on the mandatory effective date of the final IFRS 9, which may now need to be extended beyond 2015. The IASB has requested feedback on the effective date as part of its request for comment on its ED on the new impairment model.

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\(^3\) US Financial Accounting Standards Board
Financial instruments: Impairment
On 7 March 2013, the IASB published a new ED Financial Instruments: Expected Credit Losses proposing that entities should recognise and measure a credit loss allowance or provision based on an expected credit loss model.

The proposed expected loss impairment model would apply to loans, debt securities, and trade receivables measured at amortised cost or at FVOCI. The model is also intended to apply to lease receivables, irrevocable loan commitments and financial guarantee contracts not accounted for at FVPL.

The proposed model applies a dual measurement approach that reflects the general pattern of deterioration or improvement in the credit quality of financial instruments within the scope of the ED. When financial instruments are initially recognised, except when the simplified approach is applied or the financial assets are credit-impaired on initial recognition (see below), an entity would provide a credit loss allowance of 12-month expected losses. Subsequently, 12-month expected losses are replaced by lifetime expected losses if the credit risk has increased significantly since initial recognition (the lifetime expected credit losses criterion).

The credit losses allowance or provision will revert to 12-month expected losses if the credit quality subsequently improves and the lifetime expected credit losses criterion is no longer met.

To simplify the application of the lifetime expected credit losses criterion, the ED proposes that financial instruments with low credit risk at the reporting date would not meet the lifetime expected credit losses criterion. For example, a financial asset rated ‘investment grade’ at the reporting date is deemed to not have suffered significant credit deterioration and will remain as such until it is downgraded to below investment grade.

There is a rebuttable presumption that the lifetime expected credit losses criterion is met if contractual payments are more than 30 days past due.

In this model, lifetime expected credit losses would be estimated based on the present value of all expected cash shortfalls over the remaining life of the financial instrument. The 12-month expected credit losses are defined as a portion of lifetime expected credit losses associated with the probability of a default occurring in the next 12 months after the reporting date. The proposals do not define ‘default’ or prescribe the specific approaches used to estimate expected credit losses, but stress that the approach used would reflect the following expected credit losses attributes: a probability weighted outcome, the time value of money and the best available information.

An exception applies to financial assets that already have objective evidence of impairment (similar to the loss events under IAS 39) on their origination or acquisition. No ‘day one’ credit loss allowance will be provided, as the initial lifetime expected credit losses are reflected in a credit-adjusted effective interest rate (EIR). Subsequently, a credit loss allowance is recognised based on changes in lifetime expected losses following initial recognition. A gain may be recognised if favourable changes result in the lifetime expected losses estimate being lower than the original estimate that is incorporated in the EIR. A simplified approach is also introduced for trade receivables and lease receivables.

Under the proposals, except for credit-impaired financial assets, interest revenue will be calculated using the effective interest method (similar to IAS 39 today) on the gross carrying amount, unless there is objective evidence of impairment at the reporting date. If such evidence exists, an entity will instead calculate the interest revenue based on the carrying amount net of the credit loss allowance in subsequent reporting periods.
Convergence with US GAAP

The IASB's proposal grew out of a joint project with the FASB. However, due to concerns raised by the FASB's constituents about the model's complexity, the FASB has proposed an alternative model that has a single measurement objective, but which retains many of the jointly developed core principles. The FASB's current expected credit loss model would require an entity to recognise a credit loss allowance for its current estimate of the contractual cash flows the entity does not expect to collect (i.e., lifetime expected losses must be recognised on day one).

Potential impact

Estimating the credit loss allowance has always required considerable judgement. Moving from the current incurred loss model to an expected credit loss model will require more judgement in considering information related not only to the past and present, but also to the future. The expected credit losses model will likely result in earlier recognition of credit losses because it will require the recognition of either a 12-month or lifetime expected credit loss allowance or provision that includes not only credit losses that have already occurred but also losses that are expected in the future.

The proposals may increase the credit loss allowance or provision recorded by many financial institutions. The extent of the increase, however, will very much depend on the nature of the credit exposures and current IAS 39 practices. The credit loss expense is also likely to be more volatile as expectations change. Given the significant impact on accounting and credit risk processes, and the scale of the financial and regulatory capital impact, several banks have already implemented high level impact assessments and simulations.
Interaction with other phases of IFRS 9
The proposed expected credit losses model will be available for adoption only once the final version of IFRS 9, reflecting the final classification and measurement and general hedge accounting requirements, is adopted in its entirety.

Project timeline
The comment period on the IASB's ED ends on 5 July 2013, while comments on the FASB's proposals were due on 31 May 2013. We expect that the IASB and FASB will jointly discuss comments on their respective proposals. This will provide an opportunity to work towards a converged solution that will promote consistent accounting for credit loss allowances and increase comparability for stakeholders.

Financial instruments: hedge accounting

General (or micro) hedge accounting
The new general hedge accounting model is a more principle-based approach for hedge accounting that will be added to IFRS 9. It focuses on expanding the scope of permissible hedging relationships. There will be clearer links between an entity's risk management strategy, the rationale for hedging and the impact of hedging on the financial statements.

Important elements of the model:
- There will be no bright line tests for the hedge effectiveness assessment. Instead, there must be an economic relationship between the hedged item and the hedging instrument, and the effect of credit risk must not dominate the value changes that would result from that relationship. However, hedge ineffectiveness will still have to be measured and recognised.
- The fair value changes of cross-currency swaps that are attributable to changes in the foreign exchange basis spread will be accounted for as costs of hedging, i.e., recognised in other comprehensive income (OCI) and amortised to profit or loss over the life of the hedging relationship.
- A hedging relationship would be rebalanced after inception if the hedge ratio is adjusted for risk management purposes, rather than being de-designated and re-designated as currently required under IAS 39. Rebalancing applies for hedging relationships that involve basis risk.
- Hedge accounting will be permitted for risk components of financial and, for the first time, non-financial hedged items provided the risk components can be separately identified and reliably measured (e.g., the crude oil benchmark component of jet fuel).
- Aggregated exposures (combinations of derivatives and non-derivatives) will be eligible as hedged items.
- Layer components of a nominal amount may be designated as a hedged item within fair value hedges.
- A group of forecast transactions resulting in a net position may be an eligible hedged item in a cash flow hedge of foreign exchange risk.
- Hedge accounting must be discontinued when either the hedging instrument expires, risk management objectives or other qualifying criteria are no longer met.

Potential impact
The new hedging model is not expected to have a significant impact on the micro hedge accounting of banks. However, corporate entities, in particular, will now be able to hedge account for many more economic hedging strategies, which may lead to an increased focus on product development by banks to meet the new requirements.

Project timeline
The IASB is expected to issue a final standard in the third quarter of 2013. The proposals are expected to be applicable prospectively from 1 January 2015 (although, as indicated above, this may be delayed). Early application is permitted only if the hedge accounting proposals are adopted together with all other IFRS 9 requirements that have been previously finalised.

Accounting for macro (or portfolio) hedging
The IASB is still developing its accounting model for macro hedging. This project will address specific accounting for risk management strategies relating to open portfolios (i.e., macro hedging), for which the general hedge accounting proposals do not provide specific solutions.

To date, the IASB's discussions have focused on strategies to hedge the net interest margin of financial institutions. The potential new accounting approach would be a fundamentally new concept that would reflect typical strategies for managing risks in open portfolios. The IASB is developing an approach based on a revaluation of exposures by risk, which could also include exposures such as core deposits and items with prepayment features where the cash flow estimates are based on the behaviour of customers.
In May 2012, the IASB decided to decouple the project on accounting for macro hedging from the IFRS 9 project. Consequently, the development of this project will not impact the timing of the completion of the general hedge accounting project. In April 2013, as a transitional measure, the Board decided to allow entities to either continue applying the IAS 39 hedge accounting requirements for all hedges or apply the new hedge model in IFRS 9, but including the option to use the ‘macro fair value hedge accounting’ in IAS 39, until the macro hedge accounting project is finalised. In addition, the IASB clarified that financial institutions can continue to apply macro cash flow hedge accounting under IFRS 9.

**Potential impact**
The potential new accounting approach for macro hedging may be substantially different from what is colloquially referred to as macro hedging under IAS 39. Banks that have macro hedging strategies should follow the IASB’s deliberations closely to understand potential opportunities or risks in applying this accounting to their risk management strategies.

**Project timeline:**
An IASB discussion paper on macro hedge accounting is expected in the third quarter of 2013.

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**Insurance**
In 2010, the IASB issued an exposure draft on how to measure insurance liabilities. The proposals apply to all types of insurance contracts (i.e., life, non-life, direct insurance and re-insurance) as well as certain contracts with discretionary participation features. The exposure draft proposed that insurance liabilities would be measured based on current estimates of future cash flows and current interest rates, with all changes in estimates recorded in profit or loss. A number of issues with these proposals were raised by constituents and considered during re-deliberations. Accordingly, the IASB has made several important changes to the ED proposals, including the presentation of insurance liability movements due to changes in discount rates in OCI.

**Convergence with US GAAP?**
The tentative decisions made by the IASB differ from the FASB’s decisions in some important areas. As a result, the Boards have acknowledged they will not reach a converged solution. The FASB is expected to issue its ED in mid-2013.

**Potential impact**
The Boards’ proposals are far-reaching and may have a significant impact on insurers (e.g., estimating all future cash flows arising from the fulfilment of an insurance contract on a probability-weighted basis, and reporting revenue). This would have a related impact on key processes and internal controls.

The proposals in the 2010 ED resulted in a potential for significant earnings volatility, but the IASB has agreed to several changes, including introduction of a fair value through OCI measurement category as part of the IFRS 9 project, that are expected to reduce some of the earnings volatility. However, profit or loss may still be affected by the use of current estimates. The statement of comprehensive income will report premium amounts based on an allocation of the total contract premium over time. While the revisions to the proposals may reduce a potential for earnings volatility, they come with a potential for increased operational complexity.

**Project timeline**
The IASB is expected to issue a revised ED in June 2013. A final standard is not expected before 2014. The Board has not yet concluded on the effective date, but it is expected to be around three years from the issuance of the final standard. Application of the new standard at transition is expected to be based on a modified retrospective approach.

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4 The IASB and FASB, collectively.
Leases
Nearly three years after the IASB and FASB published their original joint ED on leases, they issued a revised ED based on a ‘right-of-use’ model. The model would require lessees to recognise a lease liability and a corresponding ‘right-of-use’ asset arising from their involvement in most leases. All entities would classify their leases to determine how to recognise lease-related revenue and expense. Classification would also affect what lessors record on their balance sheets.

Lease classification would be based on the portion of the economic benefits of the underlying asset expected to be consumed by the lessee over the lease term. The revised ED provides classification guidance based on whether the underlying asset is property (i.e., land and/or building and part of a building) or non-property. In summary, if the lessee is expected to consume more than an insignificant portion of the economic benefits of the underlying asset, such as most leases of equipment and vehicles, the lease would have income or expense recognition patterns similar to today’s finance leases. If the lessee is not expected to consume more than an insignificant portion of the economic benefits of the underlying asset, that is most leases of property, the lease would have income or expense recognition patterns similar to today’s operating leases.

Potential impact
Recognition of most leases on the balance sheet by lessees would be a significant change from existing IFRS. In addition, the lease expense recognition pattern for lessees would be accelerated for most of today’s operating leases of vehicles and equipment and the expense would be re-characterised as interest and amortisation. As a result, key balance sheet metrics such as leverage and finance ratios, income statement metrics, such as EBITDA, and debt covenants could be impacted.

Accordingly, the revised proposal could have a significant impact for the leasing businesses of financial institutions as the potential effect on the gearing ratios of lessees could affect lessees’ lease versus buy decisions. Structured finance transactions, such as sale and leasebacks, currently allow the financial institutions’ customers to derecognise the underlying assets from their balance sheets. The proposals may take away that benefit and could result in a substantial change in the way in which they are structured. They may even result in a decrease in such transactions with a corresponding decline in the financial institutions’ business and revenue.

As a lessee, the increase in total assets and liabilities of a financial institution could have an impact on its regulatory capital. The increase in assets may also have implications for the levies imposed by governments.

Project timeline
The comment period on the ED ends on 13 September 2013. The IASB have not yet proposed an effective date of the forthcoming standard, but it is expected to allow sufficient time for the new requirements to be implemented.

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5 Earnings before Interest, Taxes, Depreciation and Amortisation.
Implementation projects

In addition to the major IFRS projects, the IASB also has a number of items on its current work plan that deal with implementation issues. These include narrow scope amendments and interpretations. Below is a brief update on some of these current implementation projects that are of significance for financial institutions.

Novation of OTC derivatives and continuation of hedge accounting (proposed amendment to IAS 39 and IFRS 9)
The IASB proposed a narrow exception to the requirement for the discontinuation of hedge accounting in IAS 39 and IFRS 9 in circumstances when a hedging instrument is required to be novated to a central counterparty (CCP) as a result of local laws or regulations. As currently drafted, the relief does not apply to voluntary novations. The comment period ended on 2 April 2013. In response to constituents’ comments, the IASB tentatively decided to expand the scope of the amendment in May 2013 to also provide relief from discontinuing hedge accounting for: (1) voluntary novation to a CCP associated with a legislative or regulatory change; and (2) novation that provides the entity with indirect access to a CCP. The IASB confirmed that the amendment should be applied retrospectively. Furthermore, the IASB tentatively decided that re-exposure is not necessary and that the mandatory effective date of the amendment should be 1 January 2014. The IASB expects to issue the amendment in June 2013.

Defined benefit plans: employee contributions (proposed amendments to IAS 19)
The IASB proposed amendments to the accounting for contributions from employees or third parties when the requirements for such contributions are set out in the formal terms of a defined benefit plan. The objective of the proposed amendments is to provide a more straightforward alternative for accounting for employee contributions payable in a particular period that are linked solely to the employee’s service rendered in that period. The comment period ends on 25 July 2013. The amendments are expected to be finalised in the fourth quarter of 2013.

Fair value measurement: unit of account (proposed amendments to IFRS 13)
The IASB is proposing to clarify that the unit of measurement for investments in subsidiaries, joint ventures and associates is the investment as a whole rather than the individual financial instruments that make up the investment as a whole. Furthermore, the IASB has tentatively decided that the requirement to measure fair value using a quoted price in an active market, if available, would override the unit of measurement for listed subsidiaries, joint ventures, associates and cash generating units. The ED was originally expected in the second quarter. However, in May 2013, the IASB decided to consider a similar issue regarding the interaction between the use of Level 1 inputs and the ‘portfolio exception’ in IFRS 13 before finalising the ED. Accordingly, the IASB now expects to issue the ED (together with any other clarifications arising from consideration of the portfolio issue) during the third quarter of 2013. The IASB has not made a decision on the transition provisions yet. It will consider this topic after considering any further amendments to the ED that may arise from its consideration of the portfolio exception issue.

Actuarial assumptions: discount rate (proposed amendments to IAS 19)
The IASB is expected to propose clarifications for interpreting the meaning of high-quality corporate bonds for the purposes of discounting employee benefit obligations under IAS 19. The ED is expected in the third quarter of 2013.
Put options written on non-controlling interests (proposed amendments to IAS 32)

The IFRS Interpretations Committee issued a draft interpretation proposing that all changes in the measurement of put options written on non-controlling interests should be recognised in profit or loss in accordance with IAS 39 and IFRS 9. During the discussion of constituents’ feedback, the IASB tentatively decided to reconsider the requirements in paragraph 23 of IAS 32, including whether all or a particular category of put options and forward contracts written on an entity’s own equity should be measured on a net basis at fair value. The ED is expected in the second half of 2013.

Recognition of deferred tax assets for unrealised losses (proposed amendments to IAS 12)

The objective of this project is to clarify the accounting for deferred tax assets arising from unrealised losses on debt instruments measured at fair value. The ED is expected in the forth quarter of 2013.

The business impact

The IFRS changes will impact business systems and processes, as well as investor communication. Entities will need to evaluate these implications and plan their responses accordingly.

When assessing the impact of the IFRS changes, entities will need to consider the interaction between the accounting changes and wider regulatory and macro-economic challenges, including:

- Basel III
- COREP/FINREP
- Markets in Financial Instruments Directive
- Dodd-Frank Act
- Jurisdictional banking levies and taxes

Examples of some of the commercial, financial, regulatory and organisational challenges that exist for banks include:

- Managing expectations and educating external stakeholders during the period of change
- Understanding the decisions made by their industry peers
- Restructuring products when current products and business models may no longer be viable for a bank or its counterparty
- Assessing how reclassifications will impact key ratios, regulatory capital and tax
- Considering systems capability and the data required to meet the disclosure requirements
- Assessing the increased operational risk caused by changes to systems and processes
- Managing organisation-wide change: increased competition for resources, systems, data and process alignment, and management of quality and cost

In order to make an informed assessment, entities will need to understand the significant accounting and operational business impacts. Some of the new or proposed standards, in particular, those relating to the classification, measurement and impairment of financial instruments, are less rules-based. As such, management will need to exercise considerable judgement in implementing the changes to IFRS.
What lies ahead

The chart below sets out the mandatory adoption timeline\(^7\) for certain new IFRSs and amendments in issue as of 31 May 2013, and certain ongoing IASB projects which are of particular significance for financial institutions.

The dotted line highlights retrospective application requirements.

The mandatory effective dates have not yet been determined for the forthcoming standards on leases, accounting for macro hedging and insurance contracts. These standards are expected to be mandatory effective beyond 2015.

**Resources**

For more details reference can made to our full suite of IFRS publications which can be found on www.ey.com/IFRS.

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**Mixed transition provisions\(^8\):**

- IFRS 9 Financial Instruments
  - Proposed amendments to classification and measurement\(^9\)
  - Impairment\(^8\)
  - General hedge accounting\(^8\)

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\(^7\) Assumes an entity with a 31 December year end.

\(^8\) Mandatory effective date has not been determined yet, but not expected to be earlier than 2015.

\(^9\) Transition provisions have not yet been finalised and are subject to change.

\(^10\) The mandatory effective date may change.
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