I. IASB Organisation and structure

Projects with relevance to the supervision of the financial sector
Agenda

» IASB – The organisation

» Major projects
» Fair Value Measurement
  • Hierarchy
  • Classification
» IAS 39 overhaul – IFRS 9
  • Two bucket approach
  • Business Model

See also:
http://www.iasb.org/About+Us/How+we+are+structured.htm


The organisation of standard setting

- **Monitoring Board**
  - Approves Trustees
  - Reports to
  - Appoints
  - Interprets

- **IASC Foundation**
  - Monitors
  - Reviews effectiveness

- **SAC**
  - Technically advises

- **IASB**
  - Creates

- **IFRIC**
  - Interprets

- **IFRSs**
  - High quality, enforceable and global standards for publicly accountable entities

- **IFRS for SMEs**
  - Simplified IFRS, designed for small and medium-sized entities
## Financial Crisis related projects

<table>
<thead>
<tr>
<th>Estimated publication date</th>
<th>2009 Q3</th>
<th>2009 Q4</th>
<th>2010 Q1</th>
<th>2010 Q2</th>
<th>2010 H2</th>
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## Projects of MOU – Conversion with the US

<table>
<thead>
<tr>
<th>Estimated publication date</th>
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</table>
Revenue Recognition – What is it about

- Single revenue recognition model – IASB and FASB
- Revenue recognition requirements in US GAAP differ from those in IFRSs
- Both are considered in need of improvement
- To be applied across industries and geographical regions
- Principle - recognise revenue when performance obligations satisfied
- Performance obligations = transferring goods and services to a customer
Revenue Recognition – how does this apply to the financial sector

» Revenue earned on elapse of time
  • Insurance: the performance obligation is the provision of risk bearing services –
  • Banking: performance obligation is the granting of a loan or the investment into savings

» Issues
  » Acquisition costs – loss on inception
  » Time value of money not explicitly considered – issue for long term contracts
  » Remeasurement – locking in measurement would not work for long-term contracts
    - Contract boundaries
Consolidation – What is it about

» Single IFRS on consolidation to replace:
  • the consolidation requirements of IAS 27 *Consolidated and Separate Financial Statements* and
  • SIC-12 *Consolidation – Special Purpose Entities*.

» a revision of the control definition
» enhanced disclosures about consolidated and unconsolidated entities
» Principle - reporting of a parent and its subsidiaries as if single entity.
» Considerations focusing on structured entities
Consolidation – how does this apply to insurance

» Many insurance companies part of groups – either as subsidiaries or parents
» Consolidated reporting fundamental to understanding financial position of insurer and its group
» Off-balance sheet entities to which insurers still exposed to risk – need to address this issue
» IAIS view is that all things being equal – more entities should be consolidated after project completed
Derecognition – What is it about

» Improving the derecognition requirements for financial assets and liabilities in IAS 39 – currently complex to understand and apply in practice

» Convergence of the derecognition requirements in IAS 39 and US GAAP

» More disclosure about entity’s exposure to risks of transferred financial assets and liabilities
Derecognition – how does this apply to Financial Services

» Insurers transfer assets and liabilities where they may retain an interest
» When is interest truly transferred?
» What risks remain after the transfer?
» Project is about improving disclosure of risks of assets transferred
» Key issue for financial services industry in the crisis – understanding risks entities exposed to
Derecognition – what stage is the project at

» FASB implemented amendments to derecognition and disclosure in US GAAP

» Like consolidation – IASB project accelerated straight to ED because of financial crisis

Milestones

» Exposure Draft – March 2009, comments July 2009

» Final amendment of derecognition guidance in IAS 39 in the second half of 2010

» Mid 2011 – converged standard
Financial Statement presentation – What is it about

» Joint project of the IASB and the FASB – part of MoU - 3 phases
  • Phase A Completed Dec 2005 - set of financial statements and requirements to present comparative information
  • Phase B (now underway) - More fundamental issues for presentation of information in the financial statements
  • Phase C - Presentation and display of interim financial information.

» Purpose - standard that will guide the organisation and presentation of information in the financial statements.

» 3 objectives:
  • Portrays a cohesive financial picture of an entity’s activities.
  • Disaggregates information so that it is useful in predicting an entity’s future cash flows.
  • Helps users assess an entity’s liquidity and financial flexibility.
Financial Statement presentation – how does this apply to Financial Services

» Banks and Insurers required to prepare general purpose financial statements

» Accounting results and how they are presented drive management behavior

» Applicable to all industries - but do proposals work for the financial sector?

» Proposal to present statements of financial position, cash flow and comprehensive income in these parts:
  - Business
  - Income tax
  - Equity
  - Financing
  - Discontinued operations
Financial Statement presentation – what stage is the project at

Milestones
» Discussion paper – October 2008
» The IASB and FASB expect to publish exposure drafts proposing
  • Boards to publish in Q1 2010 the ED on proposals to eliminate OCI items outside of one statement of comprehensive income, finalise Q3 2010
  • ED on Financial Statement presentation in Q2 2010
  • Q2 2011 – final standard on Financial Statement presentation
IAS 39 Overhaul

» IAS 39 will be revised in three phases
  • Phase 1: Classification & Measurement - Standard delivered
  • Phase 2: Amortised cost & Impairment - Comments due 06/2010
  • Phase 3: Hedge accounting - ED expected in 12/2009

» Phase 1 resulted in significant changes to classification and measurement

» Standard not being endorsed by the EU-Komm

» Business Model will influence measurement and classification

» A glance at measurement issues:
Observable (quoted) market prices for identical assets or liabilities

if not available, use observable (quoted) market prices for similar assets and liabilities

if not available, use other valuation techniques
## Fair Value Hierarchy

<table>
<thead>
<tr>
<th>Description</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Level 1:</strong> quoted prices in active markets for identical assets or liabilities.</td>
<td>- Company A common stock traded and quoted on the New York Stock Exchange</td>
</tr>
<tr>
<td><strong>Level 2:</strong> directly or indirectly observable (market based) information.</td>
<td>- A privately placed bond of Z whose value is derived from a similar Z bond that is publicly traded.</td>
</tr>
<tr>
<td></td>
<td>- Company B common stock traded and quoted on the NASDAQ; Discount due Legally restricted Underwriters Lockup observably determined</td>
</tr>
<tr>
<td><strong>Level 3:</strong> Unobservable inputs (no market data, not correlated with market data)</td>
<td>- Shares of a privately held company whose value is based on a multiple of EBITDA.</td>
</tr>
<tr>
<td></td>
<td>- Venture Capital Investment. Fair value determined in part by the value of the latest round of financing (2 weeks ago)—should this be level 2?</td>
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</table>
Approach to accounting is changing

... something for you to think about

How do you measure the ‘fair value’ of assets and liabilities – particularly when there are no observable active and liquid markets?
## Impairment and Reversal

<table>
<thead>
<tr>
<th>Category</th>
<th>Measurement</th>
<th>Change in Value</th>
<th>Impairment</th>
<th>Reversal of Impairment</th>
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<td>Financial Assets at FV</td>
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<tr>
<td>Loans and Receivables</td>
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<td>-</td>
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<td>Income *</td>
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<tr>
<td>Held-to-Maturity</td>
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<td>-</td>
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<td>Income *</td>
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<tr>
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<td>FV</td>
<td>Equity</td>
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<td>Income (Debt-Instr.)</td>
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<td>Financial Liabilities at FV</td>
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<tr>
<td>Other Liabilities</td>
<td>Am. cost</td>
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</table>
What is changing on FV measurement?

- Derivatives
- Equity instruments
- Certain debt instruments
- Loans & receivables
- Debt Instruments with predictable Cash flows

Measured at **Fair Value** (through P/L or OCI)

- Reversal of Impairment losses
- Impairment: New approach (phase II)

Measured at **Amortized cost**

- Business model overlay
  - Reclassifications possible if business model changes

- No tainting rules
- Fair Value Option to avoid A/L mismatch

- Option to avoid A/L mismatch
- New approach
- Fair Value
- Business model overlay
Fair value measured items – IFRS9

- FI managed business model
  Derivatives

- Equity Instruments held as investments

Hedge Accounting (phase III)

- Fair value changes in P/L
  
  - No recycling

- Fair value changes in OCI

  - No impairments into P/L (hence no reversals needed)
  
  OCI reserve transferred to equity upon sale
Classification Model

- Business model test:
  - Tests met: Amortised cost (one impairment method)
  - Tests not met:
    - Contractual cash flow characteristics
    - All other instruments: Equities, Derivatives, Some hybrid contracts...

Reclassification required when business model changes:
- Fair Value (No impairment)
- FVO for accounting mismatch (option)
- Equities: OCI presentation available (alternative)
Business Model

- Business model
  - objective of holding instruments to collect or pay contractual cash flows rather than to sell prior to contractual maturity to realise fair value changes
  - not an instrument by instrument approach to classification
- Will only assess contractual terms of instruments within such a business model
- No ‘tainting’ rules for assets at amortised cost
  - gains or losses from derecognising such items to be presented separately with additional disclosures
Amortised cost

Contractual cash flow characteristics

Contractual terms that give rise to payments of

Principal

Interest

• Additional changes from exposure draft:
  • Structured debt – look through
  • Distressed debt
  • Non-recourse debt

Interest = Consideration for
  • time value of money
  • credit risk