

Global IFRS Banking Survey:  
Still far from land?



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## The results of the *Third Global IFRS Banking Survey* carried out by Deloitte were released in 2013. 70 banks from Europe, North America, Africa, Asia Pacific and the Middle East participated in the survey.

The results of the *Third Global IFRS Banking Survey* carried out by Deloitte were released in 2013. 70 banks from Europe, North America, Africa, Asia Pacific and the Middle East participated in the survey, including 19 global systemically important financial institutions. The major South African banks also had the opportunity to provide input.

The survey covered newly effective accounting standards IFRS 10 *Consolidated Financial Statements*, IFRS 12 *Disclosure of Interests in Other Entities*, and IFRS 13 *Fair Value Measurement*; however, the emphasis was on IFRS 9 *Financial Instruments*, which is expected to become effective in 2015. The aspects of IFRS 9 that were addressed are classification and measurement, impairments, general hedge accounting, and macro hedge accounting.

In the current rapidly changing and uncertain accounting and regulatory climate, the banks' expectation of the technical and operational impact of revised accounting standards on reporting, pricing and capital proved insightful. Other key aspects on which banks' views were sought are:

- (i) the convergence process between the IASB (responsible for setting international financial reporting standards) and the FASB (responsible for setting US accounting standards);
- (ii) practical implementation of the new standards; and
- (iii) whether the new accounting standards will increase comparability between banks internationally.



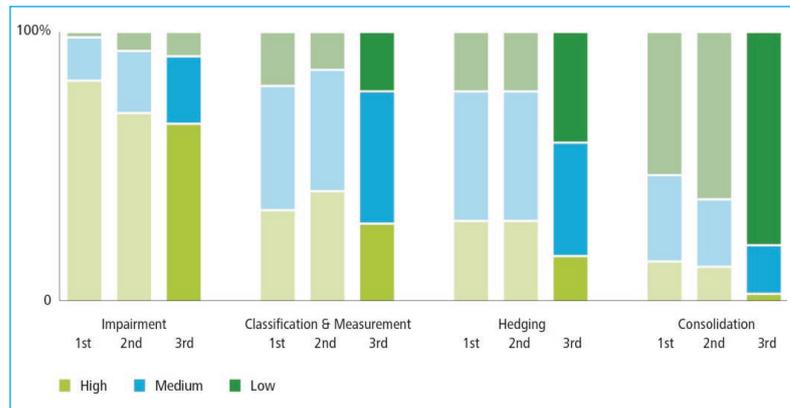
# Key findings from survey

As expected, most respondents expected the changes relating to impairment to have the greatest impact.

## Awareness and high-level impact

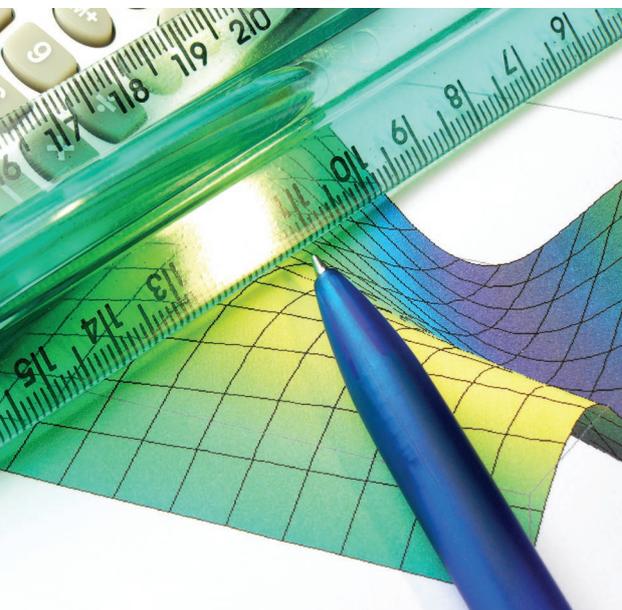
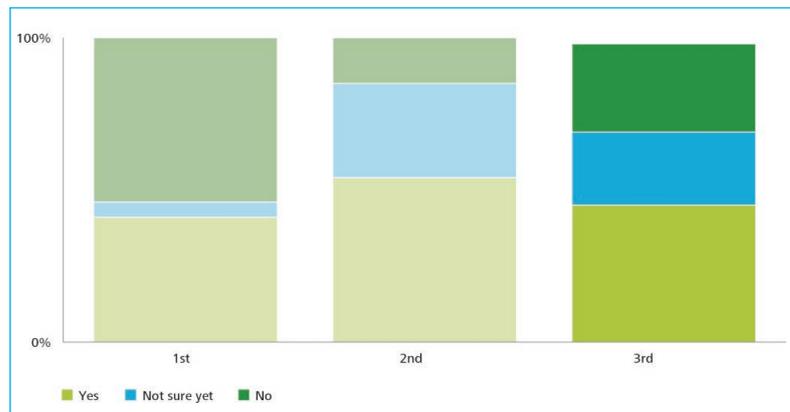
It was apparent from the survey that the vast majority of banks regard either accounting changes or Basel III as having the greatest impact on their organisations over the next five years, with local regulatory changes not expected to have as significant an impact. The vast majority of banks indicated that their boards and audit committees have either high or some involvement and awareness of upcoming accounting change.

When asked about the impact of accounting change on the business model and/or financial statements, the banks responded as follows<sup>1</sup>:



As expected, most respondents expected the changes relating to impairment to have the greatest impact.

Approximately a third of respondents indicated that they do not believe that the industry as a whole can meet the requirements of IFRS 9 to an adequate level, whilst still maintaining comparability:



<sup>1</sup> 1st and 2nd refer to the first (2011) and second (2012) global IFRS banking surveys, respectively, with the survey under discussion being the 3rd.

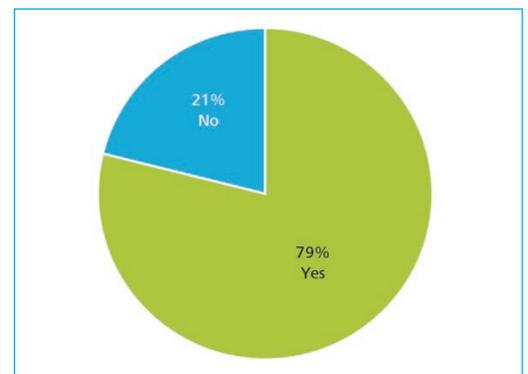
**IFRS 9: Timetable, endorsement and convergence**

Currently the proposed effective date of IFRS 9 is 1 January 2015 (deferred from 1 January 2013); however, three quarters of respondents believe that the mandatory effective date will be deferred again, which has resulted in a delayed start to implementation projects. Approximately a third of the banks indicated that the decision to early adopt the standard will not be influenced by their peer group's decision.

When asked whether they would provide pro-forma information showing restated comparatives for investors even though it is not required by the standards, approximately half of respondents indicated that they would provide limited pro-forma comparative information based on request by investors.

88% of respondents do not believe that the IASB and the FASB will converge their financial instruments standards.

**Question 2:** If the IASB goes ahead with the proposed FVTOCI category for debt instruments, do you expect a significant proportion of the assets you hold to meet regulatory liquidity requirements (excluding trading assets) to be classified as FVTOCI?

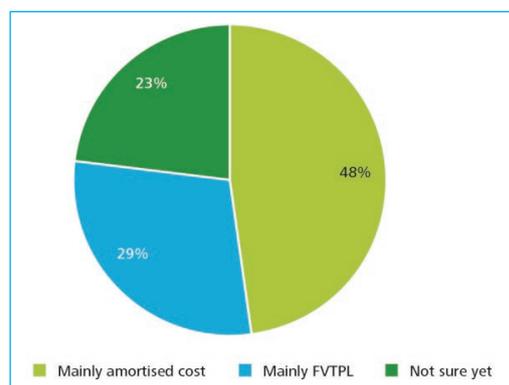


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**IFRS 9: Classification and measurement**

Banks typically hold certain assets to meet regulatory liquidity requirements. Questions were asked of the banks regarding the classification of these assets in terms of the current and proposed stipulations:

**Question 1:** Based on IFRS 9 Classification and measurement (without the proposed FVTOCI<sup>2</sup> for debt instruments category), how do you expect the assets you hold to meet regulatory liquidity requirements (excluding trading assets) to be classified?



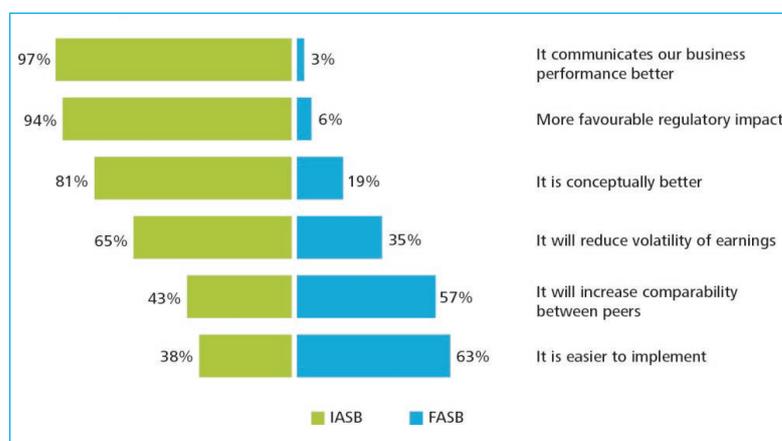
Reporting entities are not allowed to early adopt sections of the standard, with one exception – the requirement to take fair value changes in own credit on certain debt instruments to other comprehensive income. 58% of respondents indicated that they would not early adopt this stipulation. Given that IFRS 13 (which was effective 1 January 2013) requires changes in own credit risk to be reflected in liabilities measured at fair value, one would expect a significant impact on profit or loss during the period when IFRS 13 is in effect, but prior to implementation of IFRS 9, especially for entities that have not taken this into account to date.

<sup>2</sup> FVTOCI = Fair Value Through Other Comprehensive Income; FVTPL = Fair Value Through Profit or Loss



### IFRS 9: Impairment accounting

Impairment accounting is widely considered to be the section of IFRS 9 which will have the greatest impact on banks' business models and financial statements, due to the move from the incurred loss to the expected loss conceptual framework. The IASB and the FASB are currently deliberating different impairment models. 69% of respondents indicated a preference for the IASB's model, 21% prefer the FASB's model, and 10% are neutral. The reasons being as follows:



Banks are currently in the process of quantifying the impact of the proposed expected loss model.

The key difference between the IASB and FASB impairment models arises when the remaining life of an asset is greater than 12 months and a loss event is not expected to occur in the next 12 months. The "three-bucket impairment model" (IASB) would defer full recognition of an allowance for the expected credit loss until the "transfer criteria" trigger is met. Conversely, the "current expected credit loss" model (FASB) would always require an entity to recognise an allowance for the full credit loss expected at each reporting date, even if the loss event is expected to occur beyond 12 months.

There are many challenges in implementing the expected loss model, and respondents indicated the following to be the biggest challenges (in order of difficulty):

- (i) setting boundaries and triggers for transfer between buckets;
- (ii) gathering sufficient data for future economic forecasts in terms of default rates, collateral values, repayment and prepayment behaviour; and
- (iii) tracking credit quality from origination/ purchase.

Disclosure requirements also present many challenges, and respondents indicated the following to be the biggest challenges (in order of difficulty):

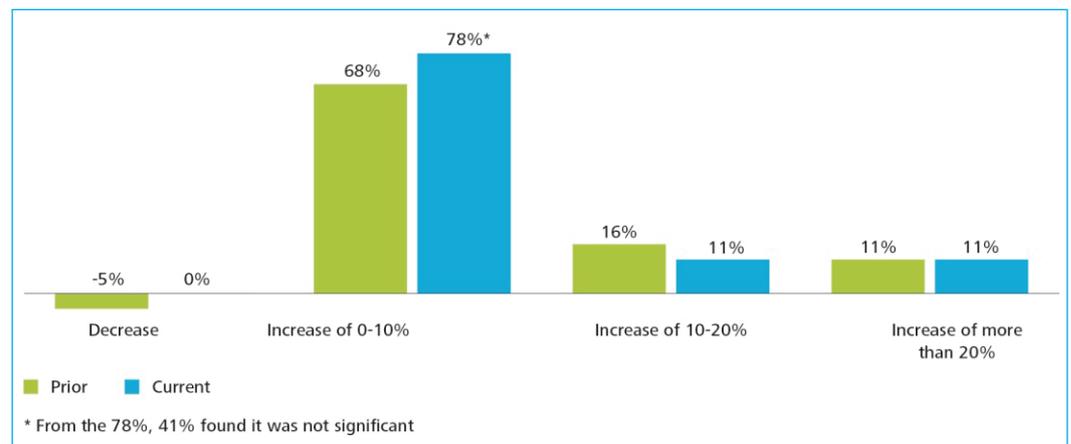
- (i) the inputs, assumptions and techniques used in estimating expected losses;
- (ii) qualitative and quantitative information relating to collateral; and
- (iii) a reconciliation of the opening and closing carrying value that includes the change in impairment allowance, write-offs and recoveries.

Banks are currently in the process of quantifying the impact of the proposed expected loss model. Many of them are not at the stage yet where they are able to estimate the impact, however, half of respondents indicated that their bucket 2 and 3 provision under IFRS 9 would exceed the impairment provision under IAS 39, although the majority of these respondents are not yet sure of the quantum.

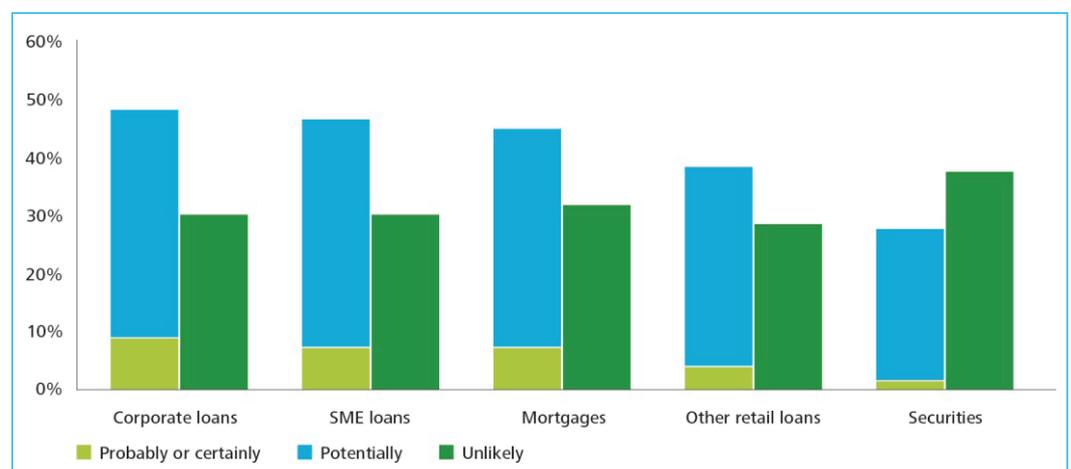
## Half of respondents indicated that their bucket 2 and 3 provision under IFRS 9 would exceed the impairment provision under IAS 39.

Respondents were asked about the impact of the expected loss model on regulatory capital requirements and product pricing. Their responses were as follows:

### Change in regulatory capital requirements:

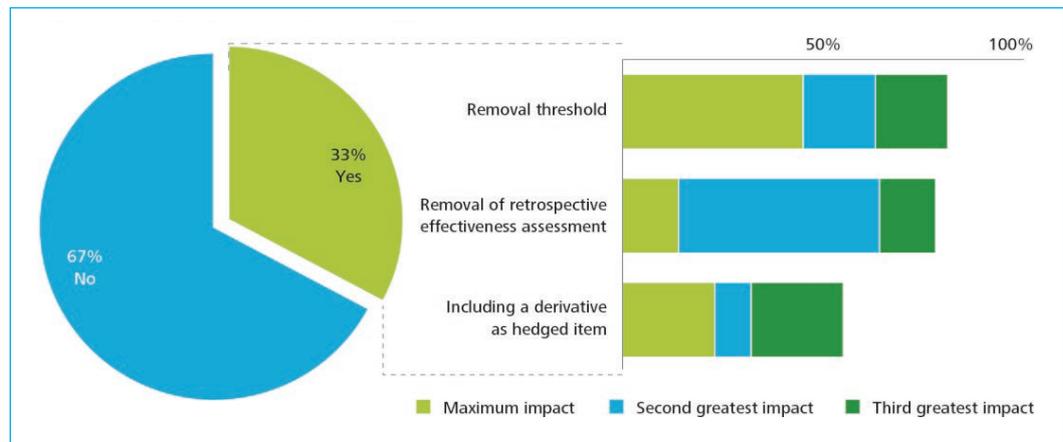


### Impact on product pricing:



**IFRS 9: General hedge accounting**

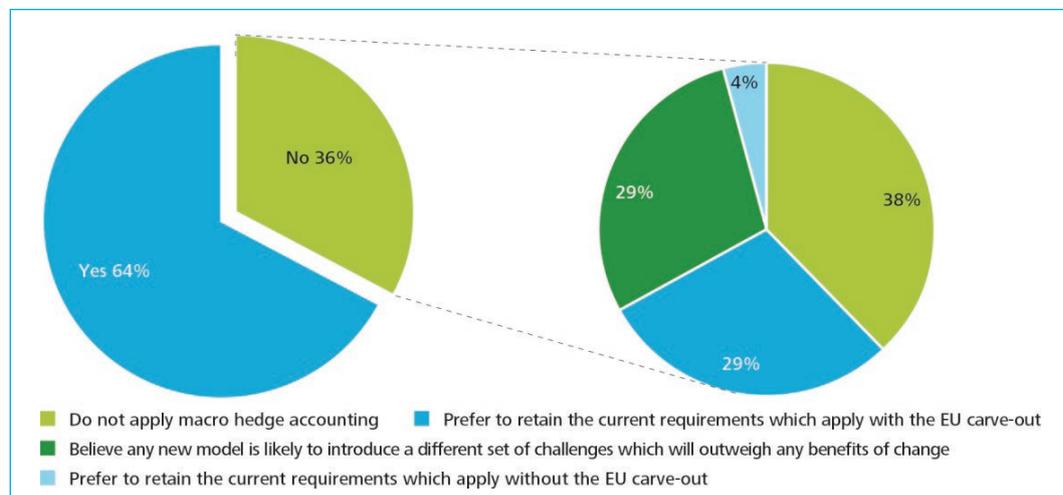
The aim of the revised hedge accounting requirements is to move from a rules-based to a principles-based framework for hedge accounting, and to encourage more entities to apply hedge accounting. However, two thirds of respondents indicated that they do not expect to increase their use of hedge accounting:



The lack of consensus in the responses seem to indicate that the IASB will continue to face opposition as it further develops changes to macro hedge accounting.

**IFRS 9: Macro hedge accounting**

Macro hedge accounting has always been a hotly contested topic, and respondents were asked whether they believe that the IASB should change the current macro hedge accounting requirements under IAS 39, and why:



The lack of consensus in the responses seem to indicate that the IASB will continue to face opposition as it further develops changes to macro hedge accounting.

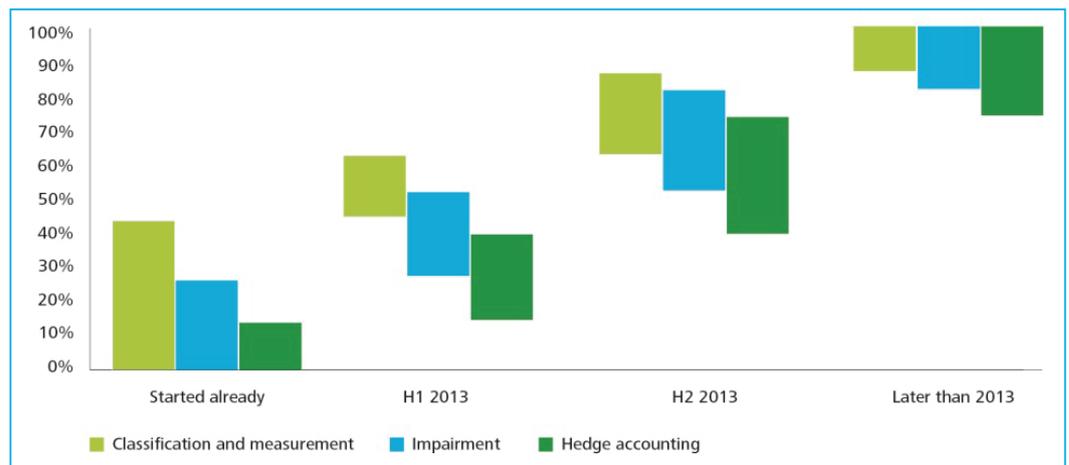
# The majority of banks have either started their implementation projects already, or aim to start during 2013.

## IFRS 9: Impact on financial statements

The vast majority of respondents indicated that they do not believe that IFRS 9 will result in a more accurate reflection of the entity's financial performance and financial position.

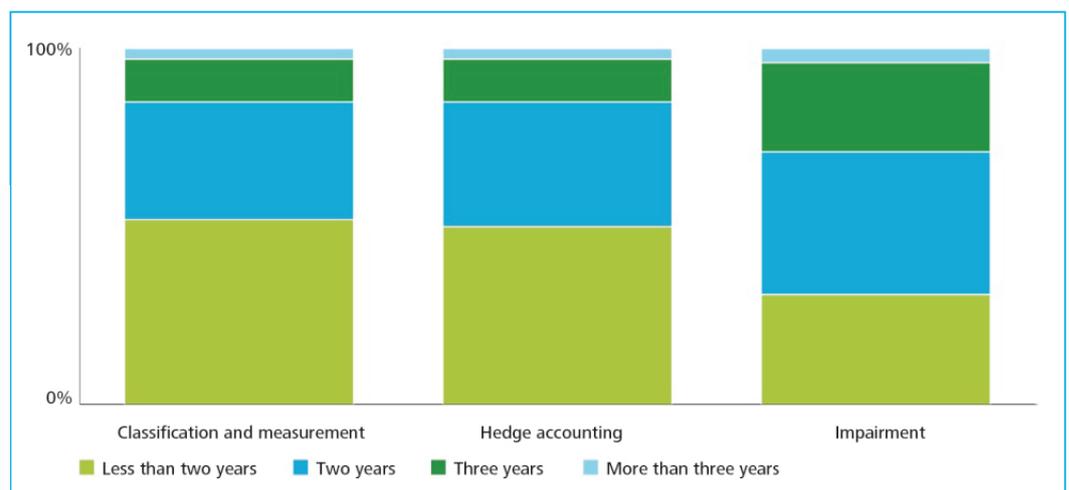
## IFRS 9: Implementation

Respondents were asked about their IFRS 9 implementation process, particularly the timing and cost implications. The majority of banks have either started their implementation projects already, or aim to start during 2013:



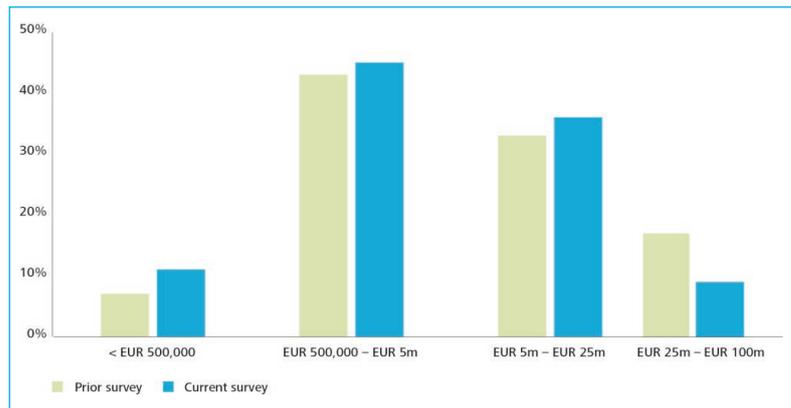
35% of respondents indicated that the uncertainty around the EU endorsement for IFRS 9 would result in the postponement of their implementation project.

When asked about the expected length of time to implement IFRS 9, it was again apparent that impairment accounting is expected to be the most complex section of the standard to implement:





It was apparent from the survey that the expected cost implications of implementing IFRS 9 are significant:



Interestingly, the majority of respondents indicated that there is no existing budget for IFRS 9 implementation in their entity!

## Interestingly, the majority of respondents indicated that there is no existing budget for IFRS 9 implementation in their entity!

### IFRS 10 and 12

Some of the banks indicated that they have already completed their IFRS 10 and 12 implementation projects, whilst most of the others expect to complete theirs during 2013.

There are some challenges in implementing the new consolidation model, and respondents indicated the following to be the biggest challenges (in order of difficulty):

- (i) application and interpretation of the standard to make the consolidation assessment on transition;
- (ii) availability and access to data; and
- (iii) implementing a process for continuous assessment of consolidation risk.

Virtually all respondents indicated that they are not considering modifying existing transactions to address the requirements of IFRS 10.

It was also apparent from the survey results that entities perceive there to be numerous operational challenges to collating the information required for disclosure purposes.

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Hardly any period in history has seen so many new accounting standards promulgated in such a short space of time.

#### IFRS 13

As regards the requirements of IFRS 13, the survey only touched on the topic of debit valuation adjustment (DVA) in the valuation of over-the-counter derivatives, i.e. the impact of own credit risk on the fair value of derivatives. 43% of respondents indicated that they currently take DVA into account, however, 75% indicated that they expect to take DVA into account once IFRS 13 becomes effective.

In a South African context, where even counterparty credit valuation adjustment (CVA) is not fully fledged, IFRS 13 is expected to have a significant impact on the pricing and valuation of financial instruments.

#### Offset

Respondents were asked whether they expect to see a material change to the extent of offsetting of financial assets and financial liabilities as a result of the amendments to IAS 32 in 2011. 60% of respondents expect no change, while 20% are not sure yet.

#### Concluding comments

Hardly any period in history has seen so many new accounting standards promulgated in such a short space of time. Not only banks, but also insurers, asset managers, corporates and public sector entities will need to consider the impact on their strategy, business model, product pricing, profitability and risk management activities. Implementing new accounting standards in a changing regulatory framework presents its own set of challenges. The operational impact on people, processes, data, IT systems, governance structures and models also need to be assessed carefully and incorporated in a well-planned implementation project, where consistency across divisions and buy-in at a senior level are paramount.

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