In depth
A look at current financial reporting issues

21 November 2017

No. INT 2017-07

IFRS 9 disclosures by banks in 2018 interim reporting and transition documents

What's inside:

At a glance

Before banks issue their first annual financial statements applying IFRS 9, many will issue interim financial statements under IAS 34. Some also plan to issue a separate transition document to help users better understand the impacts of IFRS 9 at, and beyond, adoption. This reporting is likely to receive a lot of focus from investors, regulators and other key stakeholders.

Given the lack of prescriptive guidance on what banks should include in these documents, judgement will be required. This publication is designed to help banks to navigate through the various considerations that might be relevant. A key point is that many of the transition disclosures required by IFRS 7 in annual financial statements will be relevant. Other key considerations include the level of granularity provided and how any interim financial reporting or transition document interacts with other communications on IFRS 9.

Background

In our earlier publication, 'IFRS 9 for banks – Illustrative disclosures', published in February 2017, we set out illustrative disclosures for a fictional medium-sized bank in its 2018 annual financial statements. Similarly, where a bank's IFRS 9 implementation projects include a disclosure workstream, most (if not all) of the focus to date has naturally been on the comprehensive disclosures to be included in the first annual financial statements under IFRS 9. For banks with a calendar year-end that do not early adopt IFRS 9, these financial statements will be for the year ended 31 December 2018.

However, before issuing these annual financial statements, many banks will issue interim financial statements under IAS 34. Some banks are also planning to issue a separate transition document, outside of any annual or interim financial statements, to help users better understand the IFRS 9 financial statements they will subsequently receive and the impacts at, and beyond, adoption.

Whilst IFRS 9 poses huge implementation challenges in many other areas, it is important that this 2018 pre-year-end reporting is also given appropriate attention.

In view of the limited quantitative disclosures made by most banks prior to the year of adoption, this reporting is likely to receive a lot of focus from investors, regulators and other key stakeholders. It will therefore be important that banks clearly communicate key messages in this reporting, to help users understand the new world of IFRS 9. Banks will also want to avoid inconsistencies with what is published later in the first annual financial statements applying IFRS 9.

This publication is designed to help banks to navigate through the various considerations that might be relevant in designing this 2018 pre-year-end reporting.

What is the applicable guidance?

Unlike some other new accounting standards, IFRS 9 made no consequential amendments to IAS 34, 'Interim financial reporting', to bring in specific new interim disclosure requirements. So the key requirement for interim reports prepared under IAS 34 is the general requirement in paragraph 16(a) of IAS 34. This states that an entity should provide "*a statement that the same accounting policies and methods of computation are followed in the interim financial statements as compared with the most recent annual financial statements <u>or, if those policies or methods have been changed, a description of the nature and effect of the change</u>*" (emphasis added). Paragraph 6 of IAS 34 also states that the interim financial report is intended to provide an update on the latest complete set of annual financial statements and, accordingly, it focuses on new activities, events and circumstances.

For a transition document that a bank chooses to produce at its discretion, there is no specific guidance in IFRS on the nature and content of the document. However, similar considerations are likely to apply as for IAS 34 interim reporting. In addition, since a transition document is typically intended to provide early sight of some of the IFRS 7 disclosures that would otherwise only be seen up to a year later in the annual financial statements, the disclosures will be most useful if they are a sub-set of those IFRS 7 disclosures, or they are aligned to them and any other risk management disclosures that will be provided in the annual report.

In certain jurisdictions, there might also be local rules that need to be considered for interim reporting and/or a separate transition document. These could include listing rules, securities legislation or other regulatory requirements.

What does this mean in practice?

Given the lack of prescriptive requirements, judgement will be required by banks in designing disclosures for IAS 34 interim reporting and transition documents.

In assessing the appropriate extent of disclosure, a number of factors are likely to be relevant. In particular, regulators might have expectations on the extent and nature of disclosures that are considered appropriate. In addition, the extent of the disclosures should be proportionate to the impact of IFRS 9 adoption. For example, if the impact of adoption is not significant in monetary terms, or it is restricted to a small number of financial statement line items, extensive disclosure might not be warranted. When considering the appropriate extent of disclosure, the potential future impacts of IFRS 9 should be taken into account, as well as the impact at the time of adoption. The extent of disclosures expected of larger, more sophisticated banks is also likely to be greater than for smaller, simpler banks.

However, it would generally be expected that the IAS 34 requirements could be met by disclosing:

- <u>New accounting policies</u> – A statement of the new policies required by IFRS 9 in the first set of interim reporting, given that these will not have been disclosed in

previous financial statements or interim reports. As well as explaining the new expected credit loss (ECL) impairment and classification and measurement models, disclosure should be provided of relevant policy choices that have been applied. Examples might include whether or not:
- the low credit risk exemption has been applied;
- the 30 / 90 days past due presumptions have been rebutted, as an indicator of significant increase in credit risk / default respectively; and
- comparative amounts have been restated.

- Classification and measurement changes – Quantitative and qualitative disclosures of the changes to classification and measurement arising from the adoption of IFRS 9 will be key to users' understanding of the interim reporting. These aspects of disclosure are discussed in more detail in paragraphs 42I, 42J, 42L and 42O of IFRS 7. In addition to the business model and SPPI tests, changes might arise from modification gains and losses on financial assets recognised in accordance with paragraph 5.4.3 of IFRS 9, and similar effects from modified financial liabilities as clarified by the IASB in paragraph BC 4.253 of the October 2017 amendment to IFRS 9.

- Impairment provision reconciliation – The reconciliation of the closing IAS 39 impairment provision to the opening IFRS 9 provision (as per paragraph 42P of IFRS 7) will help users to understand the adoption impacts of IFRS 9, as well as to start developing expectations of how different portfolios might be affected by IFRS 9 from period to period. To enable users to understand why the movements have arisen, this should be accompanied by qualitative information explaining the main reasons for the changes. A related disclosure that is likely to be a key focus for analysts will be the percentage of loans reported, at transition, as stage 1, 2 or 3, or purchased or originated credit-impaired, and the ECL provision coverage for each.

- Key judgements – A key focus for readers will naturally be those areas that mattered most in implementing IFRS 9 and where the greatest judgement was required. Areas likely to be most relevant for ECL, where most analyst comment and industry debate has focused, include: the criteria for identifying a significant increase in credit risk; how forward-looking information has been incorporated (including the use of multiple macro-economic scenarios); the lives used for revolving credit facilities, such as overdrafts and credit cards; and the definition of default. Where any of these areas is not a key judgement for a bank, it might nonetheless help users if this is stated explicitly in disclosures. This will avoid the risk that users look to disclosures made by peer banks on these judgements and mistakenly assume that they also apply to the bank in question. Key judgements relating to classification and measurement should also not be overlooked. These might include, for example, a judgement on whether prepayment features in a material portfolio of loans do not only provide 'reasonable additional compensation' and so prevent measurement at amortised cost, or a judgement on the level of sales considered consistent with a 'Hold To Collect' business model.

- Other relevant disclosures – Appropriate disclosures should be given about other aspects not discussed above that are necessary for a user to understand the impacts at transition, the reasons for those impacts and the key judgements that will impact the financial statements going forward.

Other factors that might be relevant

When designing disclosures for IAS 34 interim reporting or transition documents, there are a number of other factors that might be relevant. These are discussed below. It might also be helpful for banks to liaise with investors and analysts, so that their views can be taken into account when designing these disclosures.

Timing

- Cumulative disclosure over time – Some banks that produce quarterly interim reporting might wish to provide progressively more disclosure over the course of the first year of application. Whilst this might help users to focus initially on the most important aspects of IFRS 9, banks should ensure that they can justify why any additional disclosures only provided later in the year were not necessary in the first interim reporting, in order for users to have sufficient understanding of the impacts of adoption.

- Timing of transition document – Banks are likely to want to publish any transition document as early as possible in the 2018 reporting cycle. However, before committing to publication timelines, management should ensure that the timetable allows appropriate time for review and challenge, so that the numbers produced are robust and do not require subsequent amendment. This is likely to be a greater risk for those banks who have only been able to perform a short parallel run of their IFRS 9 reporting. Banks should also consider timing, relative to the publication of the 2017 annual financial statements. If a bank publishes finalised IFRS 9 numbers in a transition document, or quarterly interim report, it might well not be credible to state in its 2017 annual financial statements, only a few weeks earlier, that it cannot provide an estimate of the IFRS 9 adoption impact under IAS 8.

- Early involvement of auditors – To avoid surprises, auditors should be involved early in the process of designing IAS 34 interim reporting and any transition document. Even where auditors do not provide any report on IAS 34 interim reporting, to the extent that the disclosures provided are intended to be consistent with year-end IFRS 7 disclosures that *will* be subject to audit, obtaining the auditors' views will avoid potential issues later in the annual reporting cycle.

Comparatives

- Structure of notes – Depending on the balance sheet line items that a bank uses, there might be line items that are applicable only in the prior year but not in the current year, and vice versa. One example would be where a bank used 'Available for sale assets' as a line item in the comparative year under IAS 39. For such items, even if there is a current-year IFRS 9 line item which is considered very similar (such as 'Assets at Fair Value Through Other Comprehensive Income'), it would not be appropriate, in the supporting notes disclosures, to analyse the two amounts in adjacent columns of the same table. Therefore, thought should be given to the layout and ordering of the notes disclosures in such cases.

- Income statement impact – Where a bank does not restate prior-year amounts under IFRS 9, which is likely to be common, and the comparative income statement remains under IAS 39, it might be difficult for users to grasp the effect that IFRS 9 could have on future income statements. Whilst unlikely to be a widespread practice, banks could choose to present additional information indicating what the prior-year income statement might have looked like under IFRS 9. This would be non-IFRS information, which therefore falls within the scope of the ESMA guidelines on alternative performance measures (APMs) for EU entities (or, potentially, other similar guidance in other jurisdictions). Even where such guidelines do not exist, good practice would be to explain the reason for presenting these non-IFRS amounts, to clearly define and appropriately describe the amounts presented. As an alternative method of helping users to compare the income statement year-on-year, if a bank were to voluntarily present 2018 amounts prepared under IAS 39, similar considerations would apply as for APMs.

Other considerations

- Level of granularity – In the first annual financial statements applying IFRS 9, it will be necessary to provide disclosures under IFRS 7 separately for each class of financial instrument. Earlier reporting would therefore be expected to align to these classes, but it might not need to be as granular if, for example, such detail would be excessive in the context of IAS 34 interim reporting or a transition document.

- Other market communications – Banks might issue other external communications on IFRS 9 to the market, such as via investor presentations. Such other information is generally issued because it is considered relevant to understanding the impact of IFRS 9. Accordingly, if it is not included in IAS 34 interim reporting, management should be clear why it is not considered relevant for that purpose.

- Stand-alone document – IAS 34 interim reporting can build on, and cross-refer to, information contained in previously issued annual financial statements. However, it otherwise needs to be a stand-alone document. Therefore, even if some information has already been published elsewhere by a bank (for example, in a transition document), it would not be appropriate to incorporate that information into IAS 34 interim reporting via cross-reference. Instead, the relevant information for the purposes of the IAS 34 interim reporting not previously included in the annual financial statements should be repeated in the IAS 34 document.

- Impact beyond IFRS – Although not required by IFRS, a key focus for many users will be the impact of IFRS 9 on a bank's regulatory capital position. Where the regulatory capital regime is still evolving, any disclosure of the regulatory impact should be accompanied by appropriate explanation of any related uncertainties and assumptions used. Where capital disclosures address the anticipated effects of IFRS 9, under both the transition rules and the 'end state' rules that will apply once the transitional rules no longer apply, these different measures should be clearly distinguished. Where IFRS 9 will impact other key performance indicators (KPIs) used by a bank in its external reporting, discussion and quantification of these impacts might also be helpful for users.

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