Impact of IFRS

Australia and New Zealand Banking Group Limited

June 2005

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IFRS overview

- ANZ will be in full IFRS from 1 October 2005.
- The majority of accounting policy adjustments will be made against retained earnings.
- ANZ will elect to not make adjustments for 2004 comparatives for:
  - AASB 132: *Financial Instruments: Disclosure and Presentation*
  - AASB 139: *Financial Instruments: Recognition and Measurement*
  - AASB 4: *Insurance Contracts.*
- ANZ's IFRS Steering Committee is monitoring the adoption of IFRS and managing dedicated workstreams responsible for evaluating the impact of a specific group of accounting changes.
- Each workstream has completed its technical evaluation phase and is progressing through the design, development and implementation phases.
- ANZ is on-track to comply with IFRS by 1 October 2005.
- Work to finalise the impact is still continuing. Our most recent public comment on IFRS was the AASB 1047 disclosure in our 1st half 2005 result.

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Impact of IFRS on cash EPS

Key areas	Cash EPS impact	Potential full year impact
Goodwill	n/a	• Goodwill no longer amortised in PAT, no impact on Cash EPS unless there is 'impairment'
Fee Revenue	Small decrease	• Amortisation of fees has small impact on Cash EPS. With fees growing, this slightly lowers (lags) income in each period
Hybrids	n/a	• StEPS reclassified as debt and approximately $60m as interest expense. Impacts PAT only as already 'expensed' in Cash EPS
Share Based Payments	Small decrease	• Recognition of expense for share scheme incentives increases expenses by ~ $50m (<2% Cash EPS)
Financial instruments	Small decrease	• Allowing for bid/offer and credit spread is immaterial
Special Purpose Vehicles	Nil	• Impact of recognition of SPV's for securitisation expected to be immaterial
Hedging	"nil" (volatility)	• Impact uncertain – 'ineffectiveness' of economic hedging disclosed separately to allow this to be backed out of Cash EPS
Post Employment Benefits	n/a	• Movements in defined benefit scheme likely to be booked through Retained Earnings
Provisioning	+/-	• Specific provisions and movements in Collective Provision charged direct to P&L driving increased earnings volatility

Key impact areas: Revenue

IFRS requirements:

- Revised standards on accounting for fee income will result in more fees being deferred on initial payment and recognised either as an adjustment to yield or over the period of service.
- Fees required to be treated as an adjustment to yield will be recognised in interest income rather than fee income.
- Certain fees relating to services performed that have previously been recognised in the statement of financial performance will be deferred as at 1 October 2004, and other “yield related” fees, including loan establishment fees, will be deferred as at 1 October 2005.
- Not expected to result in a material annual impact on net profit. Fees will be amortised to income over the expected life of the loan or the period for which the service is provided.
- Substantially all of the fees in question are non refundable so are available for solvency purposes even though they are deferred

Indicative impacts:

- Profit impact: not expected to be material

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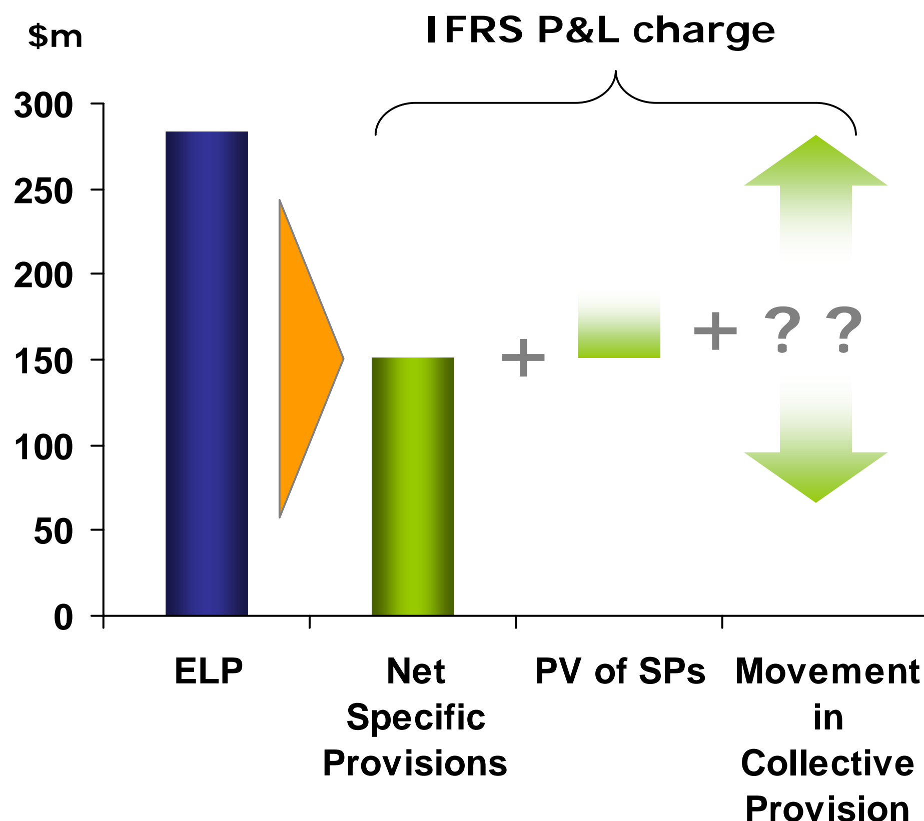
Key impact areas: Provisioning



- ELP will be replaced by a charge for:
  - Movements in Specific Provisions (SP),
  - Plus/minus a charge for movements in the Collective Provisions
- SP's determined individually for large loans and on portfolio basis for 'retail' loans
- SP's reflect the loan carrying amount less PV of expected future cash flows.
- All loans not specifically provided for are collectively assessed
- Collective Provisions replaces current general provision, however expected to be smaller on transition
- Collective Provision function of change in:
  - Portfolio size
  - Portfolio mix
  - Risk & cycle outlook

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Key impact areas: Provisioning, continued...

IFRS Component	Current Equivalent	Balance Sheet Provision	Profit and Loss Impact
Individual provisions	Specific Provision	1	Δ1 = New provisions *(including those provided for and written off in the same period)* ***Add*** increases in existing provisions ***Less*** write-backs & recoveries
Collective provisions - long-term historic performance - economic cycle adjustment - model risk and scenario modelling adjustments	ELP less specific provisions	2	Δ2 = Current Period Collective Provision ***Less*** Prior Period Collective Provision
TOTAL		**1+2**	**Δ1+ Δ2**

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Key impact areas: Provisioning, continued...

	ELP	IFRS
Losses included	• Average one year loss expected to be incurred if the same loan portfolio was held over an economic cycle	• Losses inherent within the Group's existing loan portfolio including: - specifically identified losses on individually significant loans and on a portfolio basis - presently unidentified impaired loans, provision collectively assessed • Collectively assessed losses are based on long term historic portfolio performance adjusted to account for: - current market conditions - model risk & scenario modelling
Discount rate	• Internal funding rate	• Original Effective Interest Rate (OEIR)
Credit provision on undrawn commitments	• Includes average one year loss on expected drawdowns if the same portfolio was held over an economic cycle	• Includes loss on expected drawdowns over the remaining life of the facility

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Key impact areas: Provisioning, continued...

- Collective Provision held for presently unidentified impaired assets
- Period between when event causing impairment occurs, and when impairment identified by lender, is referred to as "emergence period"
- Emergence periods will vary according to the type of loan, and are typically around 18 months
- Methodology for calculating Collective Provision considers all credit exposures for which no SP has been made
- Collective evaluation groups loans according to similar characteristics, such as credit grade, industry, geography
- Collective Provision represents an interim step, made prior to identification of loss on individual asset
- Collective Provision is calculated based on historic loss experience of the portfolio, adjusted for current market conditions (economic cycle adjustments), model risk and scenario modelling
- Movements in Collective Provision will be directionally consistent with leading indicators of credit cycle

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Key impact areas: Provisioning, continued...

- Excludes provisions for identified impairment - these are specific provisions, and assessed either on an individual or a portfolio basis.
- Basel: a general loan loss reserve, held against presently unidentified losses is eligible for inclusion in Tier 2
- FSA: general/collective provisions that a company holds in reserve against losses that have not yet been identified eligible for inclusion in Tier 2
- APRA: draft paper proposed that collective provision be ineligible for inclusion in Tier 2; and that a undistributable reserve, equivalent to the current required minimum general provision, be created from Tier 1 retained earnings to offset
- Constructive dialogue being held with APRA

Key impact areas: Post Employment Benefits

IFRS requirements:

- IFRS requires recognition of an asset or liability for the net position of the defined benefit superannuation schemes.
- On transition, ANZ will recognise the net position of each scheme on balance sheet (an overall deficit of approximately $250 million before tax as at 1 October 2004). This initial adjustment will be made against retained earnings.
- ANZ is likely to recognise future movements in actuarial gains and losses in retained earnings.

Key impact areas: Securitisation

IFRS requirements:

- IFRS introduces stricter requirements for recognition of financial assets, including those transferred to a special purpose vehicle for securitisation.
- Existing securitisation transactions have been assessed and will result in some vehicles, previously not consolidated, being consolidated by ANZ. These relate to ANZ's conduits (Aurora Securitisation, Coast Asset Corporation and Kingfisher Securitisation), in addition to securitisation vehicles where it is estimated that ANZ has retained the majority of risks and rewards.
- This is likely to result in the recognition of approximately $5.1 billion of assets and liabilities recorded on the statement of financial position based on the assets of these vehicles as at 1 October 2004.
- The impact on profit is expected to be immaterial.

Key impact areas: Hedging

IFRS requirements:

- All derivative contracts to be carried at fair value on the balance sheet.
- IFRS recognise fair value hedge accounting, cash flow hedge accounting, and hedges of investments in foreign operations. Fair value and cash flow hedge accounting can only be considered where effectiveness tests are met.
- Ineffectiveness outside the prescribed range precludes the use of hedge accounting and can result in significant volatility in the P&L.
- ANZ expects to predominantly use cash flow hedging in respect of its interest rate risk hedges, which will create volatility in equity reserve balances.
- Hedging rules will impact the way the Group accounts for hedges of its funding and for hedges of its statement of financial position.
- The current hedging results assume certain levels of hedge effectiveness at a portfolio level. Work is continuing in the areas of establishing individual hedging relationships and reporting through the hedging systems solution.

Key impact areas: Debt v Equity Reclassification

IFRS requirements:

- Change in the definition of equity and debt under IFRS, which will result in the reclassification of ANZ StEPS from equity to debt.
- The balance of ANZ StEPS as at 1 October 2004 was $987 million.
- Distributions on ANZ StEPS (currently approximately $62 million per annum before tax) will be treated as interest rather than dividends, and issue costs of $13 million will be amortised to interest (approximately $2.6 million per annum before tax).

Key impact areas: Share Based Payments

IFRS requirements:

- On adoption of IFRS, ANZ will recognise an expense for all share-based remuneration, including deferred shares and options, and will amortise those expenses over the relevant vesting periods.
- Currently,
  - ANZ does not recognise an expense for options issued to staff, shares issued under the $1,000 employee share plan, nor for the 5% discount applicable to the ANZ Share Save Scheme.
  - For deferred shares, ANZ immediately recognises an expense equal to the full fair value of deferred shares issued. Under IFRS, these expenses will be deferred and brought to account over the vesting period (1 to 3 years).
- Indicative Profit impact: approximately $50 million per year.

Other adjustments

IFRS requirements:

- **Foreign Currency Translation Reserve ("FCTR"):** IFRS allows an election to reset the cumulative translation differences for all foreign operations to zero on transition. Foreign currency gains or losses on future disposals will only include gains or losses post transition. Post translation differences on foreign operations will continue to be recorded in equity (via the FCTR) and recognised as part of the gain or loss on disposal.

- **Goodwill:** Goodwill amortisation ceases and is replaced with annual impairment testing, resulting in a reduction of expenses of approximately $220m per annum before tax.

- **Intangible Assets:** Reclassification of software as an identifiable intangible asset, where the software assets will continue to be amortised over its useful life.

- **Asset Revaluation Reserve ("ARR"):** IFRS allows a one off adjustment on transition to allow the use of the existing AGAAP valuation of land and buildings to represent "deemed cost". This is likely to result in resetting the ARR relating to Premises and Equipment to zero.

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Other adjustments, continued...

IFRS requirements:

- **Bid/Offer:** Adjustments under IFRS are likely to arise from the methodology applied to value financial instruments. ANZ currently uses “mid” rates, whereas IFRS require the use of “bid” or “offer” rates. The profit impact is not expected to be material.
- **Credit Valuation Adjustment:** On transition, IFRS requires accounting for counterparty risk in the fair value of the derivative, rather than via utilisation of a provision. The profit impact is not expected to be material.
- **Taxation:** IFRS requires a “balance sheet” approach to be adopted, replacing the current “P&L” approach, where deferred tax balances are recognised when there is a difference between the carrying value of an asset (or liability) and its tax base. Quantification of the tax effects are expected to be immaterial and finalised by September 2005.

Fair Value Option

- Last week the International Accounting Standards Board ("IASB") finalised situations when the fair value measure will be allowed for financial assets and financial liabilities.

- The approach has been broadly supported and permits the fair value designation when a contract contains substantive embedded derivatives, or when doing so, results in more relevant information because either:
  - it eliminates or significantly reduces a measurement or recognition inconsistency (in other words, an accounting mismatch); or
  - a group of financial assets and/or financial liabilities is managed and its performance is evaluated on a fair value basis in accordance with a documented risk management or investment strategy.

- ANZ expects to use the fair value option for certain transactions. Quantification of the impact of the fair value option is continuing.

APRA update

- The Australian Prudential Regulation Authority (APRA) has proposed revisions to its capital adequacy requirements to take account of the impact of IFRS.
- In February 2005, APRA released a discussion paper on its proposed prudential approach to fair value and other issues. ANZ has finalised its response to APRA and contributed to an Australian Bankers Association ("ABA") submission. The major areas of focus were:
  - Commencement date for IFRS based APRA returns
  - Credit provisioning
  - Use of the fair value measurement
- These submissions included a focused discussion on collective provisions to address the differing interpretation between APRA and the banks as to how these provisions should be treated for regulatory purposes.
- The ABA submission also highlighted proposed prudential treatment of EMVONA and post employment benefits. ANZ is not significantly impacted in these areas.
- Subsequent to the closure of the comment period, APRA will make appropriate determinations around changes to the prudential and reporting standards.
- ANZ awaits APRA's discussion papers on the proposed treatment of eligible Tier 1 capital instruments and securitisation.