

FlexFinance® IFRS

The Solution for Transparency and Consistency in Accounting Standards Application

IFRS – Greatest Shake-up in Financial Accounting and Reporting in Modern Times

The International Financial Reporting Standards (IFRS) have become a global standard in over 90 countries. However, the IFRS are constantly evolving to cope with market changes. The consideration of new valuation methods, the use of specific valuation techniques for the exposure to structured finance and new formats in financial reporting and financial accounting are challenging accounting departments around the globe.

IFRS as an international standard either fully replaces national financial accounting practices or operates as an additional, parallel accounting system for a transition period. Doing this the new accounting regulations represent a paradigm shift to the way in which many banks carry out their financial accounting and financial reporting.

+ FlexFinance® IFRS offers the most reliable and robust automated process for IFRS compliance. As a fully automated and comprehensive solution FlexFinance® IFRS covers the complete process chain of IFRS accounting.

A Modular Solution

- ▶ Individual modules are available for specific accounting requirements. Bundled into groups of modules the customer can maximise the use of encapsulated functionality such as Impairment and Hedging.
- ▶ Buy and pay for only what you need: Each group of modules consists of standardised software which is limited to specific deal types or functions. This enables the bank to compose its own FlexFinance® IFRS solution.

CASH FLOW PLAN – COVERING EXPECTED CASH FLOWS

- ▶ IFRS-compliant valuation requires the future cash flow plan of every financial instrument as a calculation basis. Therefore, FlexFinance® IFRS enriches the cash flow generation with an expected cash flow view which supports the forecasting of floating and complex fixing agreements.
- ▶ Prepayment options are included.
- ▶ FlexFinance® IFRS is able to assign a specific prepayment curve to a group of loans with similar prepayment behaviour. The impact of 'out-of-the-plan' prepayments to the remaining cash flows is taken into account.

FlexFinance® IFRS:
Modular components for the IFRS process chain

FlexFinance® IFRS – Best of Breed

FLEXFINANCE® IFRS ALLOWS FINANCIAL INSTITUTIONS TO GENERATE IFRS-COMPLIANT POSTINGS AND REPORTS.

INTEGRATED MULTI-GAAP FUNCTIONALITY: FlexFinance® IFRS is a component of the FlexFinance® Multi-GAAP platform. As such, it supports event-driven financial accounting as well as reporting and delivery of IFRS-specific recognition and valuation rules.

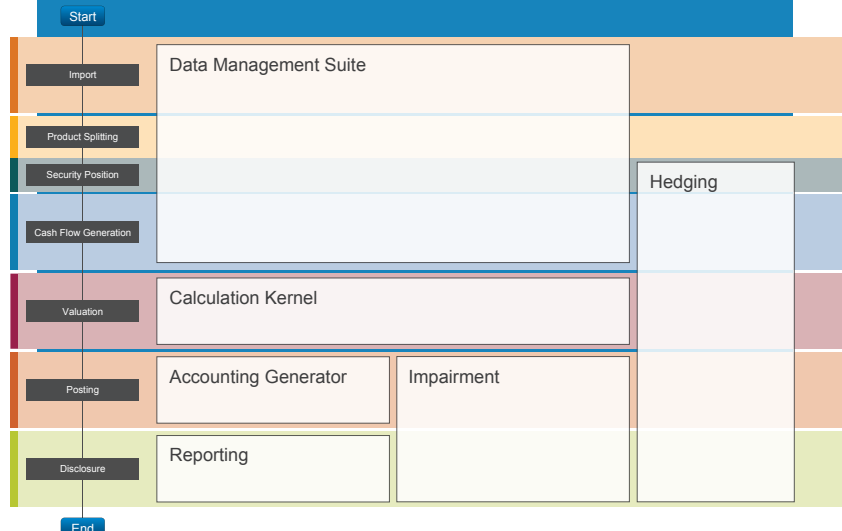
IFRS-COMPLIANT: For each process step, FlexFinance® IFRS provides methods and techniques which comply meticulously with every single IFRS rule. That applies to plain vanilla products as well as for derivatives, complex interest rate agreements, structured products and hedges.

ONE-STOP-SHOP: Complete IFRS logic for all financial instruments of a bank's portfolio is available via the pre-configured business templates.

COMPLETE A TO Z SOLUTION: FlexFinance® IFRS encompasses all processing steps starting from the import of raw data to the output of IFRS measures and reports.

MODULAR STANDARD SOLUTION: FlexFinance® IFRS is an off-the-shelf software package. Customers can choose from a range of standard modules instead of developing individual customisation.

SCALABLE FUNCTIONALITY: FlexFinance® IFRS can be easily integrated in any application environment. Depending on the degree to which third-party source systems or destination systems can manage some of the IFRS requirements, the application can be tailored to be an all-encompassing IFRS solution, a specific point solution or anything in between. In any scenario, the core principles of "one single version of the truth" and "single source of calculation" remain intact.



VALUATION – APPROVED VALUATION TECHNIQUES

FlexFinance® Multi-GAAP uses a central Calculation Kernel. FlexFinance® IFRS enriches this Kernel with several valuation techniques ensuring the calculation of EIR, AC, FV32 and FV39. All of these measures are provided as one single version of the truth and are calculated only once. If the bank decides to calculate relevant measures in another application, FlexFinance® is able to import these measures instead of recalculating them. The decision which figure is calculated where should incorporate the IFRS compliance of the applied valuation technique and audit trail capabilities.

► 1. Effective Interest Rate and Amortised Cost

FlexFinance® IFRS distinguishes between EIR relevant and irrelevant cash flows. For each cash flow type, FlexFinance® IFRS provides a separate amortisation amount. This enables FlexFinance® IFRS to support analyses and a chart of accounts dealing with separate positions e.g. for premiums and discounts, transaction fees, forward adjustments, costs of embedded derivatives separated from the host contract, hedge adjustments by termination of a hedging relationship, basis adjustments by late hedges and unwinding.

FlexFinance® IFRS amortises each relevant cash flow based on EIR over the period the cash flow economically relates to. This can be the expected lifetime of the deal, country specific rules (e.g. maximum 2 years), a fixed interest period or a specific date determined by the bank.

Changes to the financial instrument during its lifetime such as the fixing of floating interest, backdated contractual adaption of deal data are considered while recalculating the EIR and/or the amortisation schedule.

► 2. Fair Value

The fair value principles are the core of IFRS. Even financial instruments recognised and valued at AC due to their accounting category are to be valued at FV for several disclosures.

For fair valuing FlexFinance® IFRS includes valuation functionalities beside others for complex and/or embedded derivatives. It also provides mark-to-model valuation of classical illiquid instruments (e.g. retail loans). For all valuation requests FlexFinance® IFRS provides sophisticated IFRS-compliant approaches.

FlexFinance® IFRS uses the discounted cash flow approach to compute a mark-to-model fair value of loans. The discounted cash flow analysis of FlexFinance® IFRS takes all risk associated with the financial instruments into account. These include: cash flow timing and variability, benchmark market rate risk, credit risk (captured through credit spread), credit risk mitigation instruments (captured through the collateral enhancement weighting coefficient), risk of embedded options (captured either through option pricing models or on a retail portfolio level through e.g. prepayment curves), liquidity and operational costs (captured through an initial residual spread incorporated in the discount rate).

For each fair value provided through FlexFinance® IFRS makes available the level of the fair value hierarchy into which fair value measurements are categorised in their entirety.

IMPAIRMENT – SPECIFIC PROVISION AND COLLECTIVE ALLOWANCE

FlexFinance® IFRS supports both value adjustments which are applicable under IFRS: the specific provision of individual deals and the collective impairment for groups of deals. With regard to the volume of a receivable, FlexFinance® IFRS covers both the requirements of a value adjustment for significant assets and for non-significant retail loans. It considers the utilisation of collateral as well as the associated cost of liquidation.

- The FlexFinance® IFRS module “Specific Provision” supports the individual impairment of financial assets.
- The FlexFinance® IFRS module “Collective Impairment” supports the impairment for IBNR credit losses (Incurred But Not Reported).

Both modules support and whenever possible fully automate the risk provisioning process including revaluation, financial accounting and disclosure.

HEDGE RELATIONSHIPS (HEDGING)

FlexFinance® IFRS covers the 3 pillars of hedging:

1. Hedge management including documentation and maintenance such as designation/dissolution.
 2. Hedge effectiveness: the challenge is to make economical hedges effective under IFRS.
 3. Hedge accounting: considering effective hedge in financial accounting while considering hedge specific accounting events and attributes in the setup of the accounting engine.
- FlexFinance® IFRS supports all functionalities necessary for the IFRS-compliant valuation, accounting and disclosure of financial instruments in a hedge relationship.

HEDGE RELATIONSHIPS (HEDGING) – CONTINUED

- ▶ The application includes the processing which is necessary to:
 - perform prospective and retrospective effectiveness test
 - 1. Prospective method:**
 - Market Data Shift Method
 - 2. Retrospective methods:**
 - Dollar Offset Method (ratio analysis)
 - Advanced Dollar Offset Method (threshold test + ratio analysis)
 - Regression Analysis
 - Benchmark Interest Rate Method
- build hedge specific security positions. Under IFRS separate securities positions are to be built for securities subject to hedging (especially as a hedge designation can be carried out in full or in part),
- generate debits/credits representing all accounting events for an IFRS-compliant financial accounting of financial instruments which are part of a hedge relationship,
- provide data marts as basis for the IFRS-compliant reporting of hedges under IFRS 7.
- ▶ FlexFinance® IFRS includes a hedge manager which supports the maintenance of hedges with comprehensive functions to be viewed and accessed through web-based dialogue boxes. The risk management strategy, the pursued objectives as well as texts can be captured and existing documents can be loaded. Documents are managed in a log book in compliance with auditing requirements. The designation, all manual changes and the termination of the hedging relationship are subject to a workflow-based approval process. Hedged items and hedged instruments can be chosen from a list of financial instruments.
- ▶ Compared with other methods for testing hedge effectiveness, the Benchmark Interest Rate Method, exclusively provided through FlexFinance® IFRS, has the following main advantages:
 - Efficiency: The method enables the bank to distinguish between effective and ineffective hedges over the entire lifecycle of a hedge.
 - Ease of implementation: The method requires only directly available data such as the principle terms of the hedged items and of the hedging instruments as well as market data e.g. LIBOR rates, swap rates and FX rates. Other methods require various additional parameters.
 - Transparency: The calculated measures can be traced down to the deepest level.
 - Compliance: The measures used in the effectiveness test replicate the risk management strategy applied by the bank. The best practice experience of FlexFinance® IFRS shows that economic hedges do not receive the attribute “effective under IFRS” if the retrospective effectiveness test is done based on Dollar Offset Method or even on Advanced Dollar Offset Method using threshold test and/or ratio analysis.
- ▶ In FlexFinance® IFRS, hedging is integrated into the event-driven financial accounting. The FlexFinance® Accounting Engine is a rules engine which generates debit/credit entries for all business events as well as accounting events which occur during the life cycle of a financial instrument. While generating debits/credits it takes into account hedge specific attributes such as hedge type, hedged risk type, hedge quota etc. For hedge specific accounting events like designation or termination separate accounting rules can be assigned.

REPORTING – NOTES AND OTHER DISCLOSURES

- ▶ FlexFinance® IFRS includes data marts and a reporting tool for disclosure purposes. These modules ensure a separation of data storage and reporting. As such, it is possible to define individual reports based on data marts according to the specific requirements of IFRS 7.
- ▶ FlexFinance® IFRS supports the statements which are part of the annual financial statement and provides the input for:
 - Balance sheet
 - Income statement
 - Notes
 - Segment reporting
 - Cash flow statement

FINANCIAL ACCOUNTING – TAKING IFRS-BASED RECOGNITION AND MEASUREMENT INTO ACCOUNT

- ▶ FlexFinance® IFRS is a component of the FlexFinance® Multi-GAAP solution. IFRS valuation and measurement rules are presented in a deal-specific classical financial accounting. IFRS-specific valuation elements can be fully posted as independent accounting elements or can be reduced for the purpose of transfer to selected events and valuation elements.
- ▶ FlexFinance® IFRS is delivered with business templates including accounting logic for all types of financial products.



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Advantages

- ▶ Reliable and robust automated process for IFRS compliance second to none. FlexFinance® IFRS covers the complete process chain of IFRS accounting.
- ▶ Only raw deal data as input required. This cuts to zero project risk related to adaptation of existing systems.
- ▶ Comprehensive implementation of IFRS in the standard software: The solution is delivered off-the-shelf with little need for bespoke developments during the project.
- ▶ Minimum project work using the Ready-to-Go concept: The standard setup of the software, including accounting logic and reporting, is part of the delivery and can be individually adjusted to the specific accounting policy without any IT-knowledge.
- ▶ Fast and low-risk implementation: Business templates included in FlexFinance® IFRS sample deals help the user to immediately understand or adapt the in-built proposals for solution.
- ▶ Besides a standard chart of accounts taking IFRS-specific challenges regarding the separation of valuation elements into account, the business templates contain the IFRS accounting logic for numerous banking products as well as the associated standard reporting procedure (e.g. FINREP).
- ▶ FlexFinance® IFRS is an accounting solution which copes with IFRS challenges: Based on FlexFinance® Multi-GAAP IFRS-specific requests regarding recognition and measurement are considered in a business-event-driven, double-entry financial accounting. Doing this effective audit compliance is provided.
- ▶ Resources are conserved owing to maximum automation and centralisation of processes: The IFRS requirements are covered by the standard software and do not have to be implemented via pre-processing during the project.
- ▶ Easy installation: FlexFinance® IFRS only expects the raw data of the individual deals so no IFRS-specific requirements need to be implemented in the upstream systems.
- ▶ Quick and reliable project progress: Ensured by standard procedure based on the successful FERNBACH Implementation Methodology.

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