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FINANCIAL SERVICES

IFRS: the race is on... The last lap!

KPMG Survey of the Romanian Financial Institutions' Use of International Financial Reporting Standards compared with Romanian Accounting Standards

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KPMG in Romania

Contents

I. Foreword

Almost at the finish line… where the future begins

Global trends

The recession and financial turmoil of recent years has exacerbated the growth differential between emerging and developed economies, with banking sectors in emerging markets continuing to grow while those in certain developed economies have stalled or even contracted. In Germany, Spain, Switzerland and the Netherlands, for instance, the banking sector shrank between the end of 2007 and the end of 2010, as did the total size of the E.U. banking sector. By contrast, Chinese banking assets almost doubled over the same three-year period, while Brazil's sector expanded by almost 80 percent.

> "Big changes are always difficult, but the current context makes the convergence process all the more important."

European leading banks' profits up in 2010 but risk from sovereign debt crisis may turn the tables. The leading 15 European banks made collective profits of €85 billion in 2010, double the amount recorded in 2009 and up from losses of €25 billion in 2008. They look well-placed for recovery in normal conditions – but sovereign debt concerns may mean that difficult times are looming again. European banks' exposure to sovereign debt is a major challenge, particularly in the context of the eurozone crisis with Italy now under scrutiny and even France giving cause for concern.

European Union bailout plans have forced troubled countries to implement severe austerity measures that have produced recessionary spirals, decreasing the chances that they will be able to meet skyrocketing obligations. On 27 October 2011, Europe's leaders announced a "comprehensive set of additional measures reflecting Europe's strong determination to do whatever is required to overcome the present difficulties." The three pillars of the bail-out package (50% haircut on Greek debt, € 114.7 billion recapitalization of Europe's banks, EFSF - € 1 trillion war chest) will come with new challenges in relation to the accounting treatment of the Greek sovereign haircut, regulatory implications, capital raising options (i.e. external capital, hybrid conversion, state aid, other internal measures – retained profits, scrip dividends, balance sheet deleveraging, and accelerated portfolio run-offs). These measures aim to prevent contagion from the sovereign debt crisis in peripheral EU member states affecting the wider EU economy and in particular the banking environment, investment and capital markets, as well as government debt sustainability.

Challenges for the Romanian Financial Sector

The Romanian financial sector is not only affected by the challenges faced by the European financial system and in particular, European banks' exposure to sovereign debt, but also has to deal with the changes in the local regulatory framework, brought by the IFRS conversion project with implementation date 1 January 2012. Also, as mentioned further in this publication, a new Civil Code entered force in October 2011.

Big changes are always difficult, but the current context makes the convergence process all the more important. Time has been and still is the first challenge – there are only few weeks until 1 January 2012 and, although the transition period started in 2009, many aspects such as the new chart of accounts, the prudential regulations and the tax aspects of IFRS implementation have only recently been solved or are still in the development process. Solving these issues has generated extensive discussions between the three main players involved – credit institutions and the Romanian Association of Banks (ARB), the National Bank of Romania (NBR) and the Ministry of Public

Finance (MFP). Furthermore, the difficult economic situation, reflected by the concentration of resources in monitoring credit portfolios and by the need to reduce expenditure, makes it more difficult to find a balance between cost and the reliability of the solutions implemented by banks.

> "The Romanian banking sector has managed to maintain a capital-adequacy ratio of approximately 13.5% (September 2011)."

The IFRS convergence project has required a significant effort from banks as a whole, in order to analyze and report the new information in accordance with the required standards. During the implementation stage, IT systems proved to be a significant factor together with the appropriate knowledge about new reporting requirements. Thinking in terms of efficiency, there is no place for temporary solutions. Experience proves that many "temporary" solutions set up at the moment of the conversion to IFRS remain in force for many years, even after the conversion process ends, even though this may require a large amount of work, and a detailed analysis proves their inefficiency in terms of cost.

Although the global economic crisis highlighted vulnerabilities and affected the financial services industry, the Romanian banking sector has managed to maintain a capital-adequacy ratio of approximately 13.5% (September 2011). Still, the ongoing sovereign debt crisis in the Eurozone would affect also Romanian banks capital and liquidity needs and their management of Risk Weighted Assets (RWA). Additionally they will have to reduce the mismatch on the funding gap, meaning they will have to raise more deposits. Competition to raise deposits has picked up, with many Romanian banks offering high interest rates for EUR deposits and also higher than inflation rates on RON deposits. The latest announcement by the Austrian National Bank requiring Austrian banks to reduce their Loan to Deposit ratios to 110% could drive the price even higher.

However, as well as international developments, the short-term outlook for the Romanian financial system depends on a restoration of confidence in the domestic economy, of economic growth which seems to be positive in 2011, and developments related to the widespread uncertainty over the European economy.

Several key figures for Romanian financial institutions are shown below:

	December 2010	September 2011
Total Banking Assets	EUR 79.8 bn.	EUR 80.3 bn.
Loans to deposits ratio	113.46%	118.63%
Non-performing loans ratio	11.85%	14.18%
Return on assets ratio	-0.16%	-0.31%
Return on equity ratio	-1.73%	-3.37%

Source: NBR Statistic reports

Financial institutions have probably learned their lesson about the economic value of collateralized lending. One of the current challenges is the illiquid real-estate market, which makes it difficult to estimate the recoverable value of collateral and thus also makes it difficult to reach a decision about the loan-to-value rate at the moment a loan is granted, as well as to assess the impairment on existing loan portfolios.

> **"The new IFRS 12 disclosures require specific and extensive disclosures about interests in so-called 'structured entities'."**

In 2007, the news was dominated by the Romanian banking market being seen as the preferred target for the expansion of most important European financial institutions. Currently, the headlines underline concern over the profitability and sustainability of these investments. Therefore, shareholders of these players are now debating whether maintaining this capital represents an opportune decision, in the context of more stringent European economic pressures. In spite of such restrictive conditions and the current fragility of a sustainable lending capacity with related effects on economic recovery, Romania still offers growth opportunities for banks. The need for infrastructure development, creation of a sizeable SME sector, the quality of the labour force and generally the continued low level of penetration of the banking sector in Romania could be the driving forces for future growth of the local banking system.

Tax impact of conversion to IFRS

As a result of the IFRS local reporting framework implementation starting 1 January 2012, a series of adjustments for certain items booked by financial institutions will be necessary, to ensure compliance with the new accounting treatment. This will raise questions about the relationship between the accounting rules and the tax treatment to be applied. Should this relationship be considered as independent – **separate rules in determining taxable profits/tax losses?** Or should it be considered dependant – **general accounting rules to be applied for determining the taxable profits/tax losses, with a limited number of further tax adjustments?** The answer should be soon provided by the tax authorities, following further consultation both with the supervision authority and the banks.

The New Civil Code, effective 1 October 2011, has a significant and immediate impact on the financial services sector.

The New Civil Code makes radical changes and fully replaces the 1864 Civil Code, by also consolidating doctrine and case law. It is crucial for all financial services entities to promptly re-address key legal risks and reconsider major aspects of their legal documentation, from offerings and negotiation to standard agreements. The contractual documentation and the risks related to contract execution and performance have to be tailored to reflect the new regulations on adhesion contracts, standard and atypical clauses, statute of limitations, termination, damages and related penalties, guarantees, banking contracts etc.

Consistency between financial information across time will remain a challenge for banks.

Over the course of 2010 and 2011 a number of new disclosure requirements were issued as part of the IASB's annual improvements projects. These involved amendments to existing standards as well as the introduction of new standards. The new requirements include IFRS 7 Financial Instruments: Disclosures amendments related to credit risk and transfers of financial assets, IFRS 12 Disclosures of Interests in Other Entities and IFRS 13 Fair Value Measurement disclosures. These requirements have been introduced mainly because of frequent requests from banks' stakeholders to provide more specific information on a broader range of risks and activities which banks are involved in. Thus most banks will need to find a sensible way of condensing the information (such as fair value estimation details) so that it is available to stakeholders without being buried under a wealth of other information that makes it difficult, if not impossible, for the reader of the disclosure to extract the relevant information and understand its overall impact.

During the financial crisis there was a perception among some users of financial statements that there was a lack of transparency about the risks to which some banks were exposed due to their involvement with 'special purpose vehicles', in particular when the banks did not consolidate such vehicles. The new IFRS 12 disclosures seek to address this issue by requiring specific and extensive disclosures about interests in so-called 'structured entities'.

The study

The aim of this study is to highlight for the last time (at least for banks) the differences between IFRS and Romanian GAAP in the banking and financial sector. In recent years, the two systems have moved closer together on certain conceptual frameworks, but important differences still remain to be solved which this publication seeks to highlight and explain. The research was carried out by a team of professionals from KPMG in Romania and covers 22 Romanian banks (large, medium and small) that report under both IFRS and Romanian GAAP including 7 banks from the top 10 in terms of total assets. This research is similar to that performed by KPMG Romania in the past three years.

> **"The main differences between the Romanian GAAP applicable to banks and IFRS were still related to loan impairment provisions."**

The survey is based on the banks' financial statements as at 31 December 2010 as well as their annual reports and, for 8 banks where such information was available, also on their interim reporting for the first six months of 2011. The banks were chosen to give a wide range of business profile, market share and strategy. The survey covers 13 topics, with one chapter per each main topic. Each chapter summarizes the key differences, and provides a concise description of the context and accounting background with the results of our analysis. We have also analyzed data obtained from 13 Non-Banking Financial Institutions for the year ended 31 December 2010.

Our survey revealed that the main differences between the Romanian GAAP applicable to banks and IFRS were still related to loan impairment provisions. The Romanian Banking association, the National Bank of Romania and the Ministry of Public Finance together with the banks and their auditors are trying to reach common solutions for estimating the loan IFRS impairment provisions that will agree the accounting, fiscal and prudential views.

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KPMG in Romania's Partners and staff have carried out audits of many banks under both IFRS and Romanian GAAP. We understand the differences between the two systems and can use our experience to assist banks and financial institutions with their reporting requirements under both IFRS and Romanian standards. We have a dedicated banking team, with detailed knowledge of the Romanian financial services sector.

KPMG's people are always keen to keep abreast of latest developments and to anticipate what changes are likely to happen in the future. This is a particularly interesting time for banks and for the auditing profession, which have a critical role in the global economy. We like to think that we can play a part in strengthening standards and in promoting wider use of IFRS, which allows easier comparison between audits carried out in different countries, hence aiding transparency.

This publication was made possible by the invaluable input of KPMG Romania professionals with a strong background in the financial and banking sectors.

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ADVISORY

Intelligent Financial Reporting Solutions

Our team combines in-depth IFRS experience with a detailed understanding of regulatory requirements.

At KPMG we are prepared to assist you in finding appropriate solutions for complex financial reporting issues under IFRS. The planned transition to IFRS as a basis of accounting for credit institutions starting 1 January 2012 has already resulted in changes across credit institutions, affecting systems, processes and people alike. We expect this to continue going forward, as credit institutions strive to properly operate in the new IFRS framework.

Our team's IFRS expertise is focused in the following areas:

Impairment of financial assets
Effective interest rate implementation
Fair value methods for securities and derivatives
Cash Flow and Fair Value Hedge Accounting models implementation (including complex macro-hedging models)
Assessment of embedded derivatives (analysis of separation and measurement)
Professional training courses for all relevant IFRS standards
Documentation of IFRS accounting policy manuals
Impact analysis of expected changes in IFRS

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II. Introduction

This survey takes account of authoritative pronouncements issued and effective under IFRS and Romanian Generally Accepted Accounting Principles (GAAP) until 30 June 2011. The Romanian GAAP used in this publication is that prescribed for banks and non-banking financial institutions (hereinafter referred to as "financial institutions") and is regulated by National Bank of Romania Governor's Order no. 5/2005 with subsequent amendments up to 31 December 2008 and by National Bank of Romania Governor's Order no. 13/2008 with subsequent amendments starting 1 January 2009.

The Romanian accounting standards applicable to financial institutions are set the National Bank of Romania ("NBR"). In the previous year the NBR has issued Order 9/2010 in which it is stipulated that IFRS is the accounting framework under which the banks should prepare their individual financial statements starting with the 2012 financial year. This adds to the existing requirements that the Romanian banks should use IFRS as a framework for their consolidated financial statements.

> **"Postponing will allow entities more lead time to implement the requirements of all phases of the IAS 39 Financial Instruments."**

The International Accounting Standards Board (IASB) is constantly developing new projects that directly impact banks and consider the potential accounting implications of regulatory requirements. In August 2011 the IASB published an exposure draft (ED/2011/3), which proposes to postpone the mandatory effective date of *IFRS 9 Financial Instruments* (2009) and IFRS 9 (2010) to 2015 with early application permitted. The proposals reflect the extension of the timeline for completion of the remaining chapters of IFRS 9 (hedge accounting and impairment) beyond the previous target date of June 2011, and delays in completing the standard on accounting for insurance contracts. Postponing the effective date will allow entities more lead time to implement the requirements of all phases of the *IAS 39 Financial Instruments: Recognition and Measurement* replacement project at the same time, particularly those within the European Union and other countries where international standards have to be formally endorsed before they can be used.

This survey is based on annual reports and financial statements for the year ended 31 December 2010 as well as interim financial information for the six month period ended 30 June 2011 only. Also, certain conclusions from our previous years' surveys are brought forward for comparison purposes.

All numbers in this report are expressed as percentages. The survey is not focused on detailing all differences. Even if the guidance is similar, there can be differences in the detailed application, which could have a material impact on financial statements. This survey focuses on the measurement similarities and differences most commonly found in practice.

When applying the individual accounting frameworks, readers should consult all the relevant accounting standards and, where applicable, national law.

III. Conceptual Framework

IFRS includes a conceptual framework. The principles set out in this framework provide a basis for setting accounting standards, and a point of reference for the preparation of financial information where no specific guidance exists

The legal framework for the application of Romanian GAAP for banks is the Accounting Law (nr. 82/1991) and National Bank of Romania (BNR) Governor's Order 13/2008 (which on 1 January 2009 replaced BNR Governor's Order 5/2005 with subsequent amendments). This regulatory framework stipulates basic accounting principles and requirements for bookkeeping. It establishes a coherent reporting basis for banking and other financial institutions, including definitions of basic terms. Romanian banking and non banking financial institutions must use IFRS instead of Romanian GAAP for the preparation of their consolidated financial statements, while for other enterprises, use of IFRS is optional.

> **"The IFRS Framework requires that financial information should be understandable, relevant, reliable and comparable."**

The Romanian fiscal and prudential base, however, is still based on Romanian GAAP regardless of which accounting standards the banks use for the preparation of their financial statements. Consequently, these banks need to understand the similarities and differences between IFRS and RAS.

Qualitative characteristics of financial information

IFRS

Financial information must possess certain characteristics for it to be useful. The IFRS Framework requires that financial information should be understandable, relevant, reliable and comparable.

Romanian GAAP

Romanian GAAP information disclosed in financial statements must be understandable, reliable, and comparable and is considered from the viewpoint of materiality (comparable to IFRS). A general rule applies that entities are required to maintain their accounting records correctly, completely, conclusively, understandably, in a clear format and in a manner ensuring permanence of accounting records.

The substance over form principle is replaced by the requirement for selection of a method providing true and fair presentation of substance within legal form, however not beyond it (see accounting for financial leases). Certain reporting disclosures are found in other prudential reporting that the Romanian financial institutions make to the BNR.

Reporting elements

IFRS

The IFRS framework presents five reporting elements: assets, liabilities, equity, income (includes revenues and gains) and expenses (includes losses). Assets are resources controlled from a past event. Liabilities are present obligations arising from a past event. Assets and liabilities are recognized in the statement of financial position (the former balance sheet) when it is "probable" that economic benefits will flow in to or out of the entity, and those benefits must be able to be measured reliably. Equity is the residual interest in the assets after deducting the entity's liabilities. Income is increases in economic benefits that result in increases in equity other than those relating to contributions from equity participants. Expenses are decreases in economic benefits that result in decreases in equity other than those relating to distributions to equity participants.

Romanian GAAP

Romanian accounting legislation refers to the same components of accounting recognition (i.e. property, including assets, payables, including liabilities, equity, income and expenses). However, well-developed definitions of these basic terms are not available. Certain items of these basic components have been defined in Romanian accounting standards, especially for financial institutions.

IV. Main differences between Romanian GAAP and IFRS

Cezar Furtuna: "Although we are fast approaching 1st January 2012, the differences between Romanian GAAP and IFRS still remain important and create volatility in the interpretation of results of Romanian banks"

Financial statements of banks

Impact on Profit and Loss

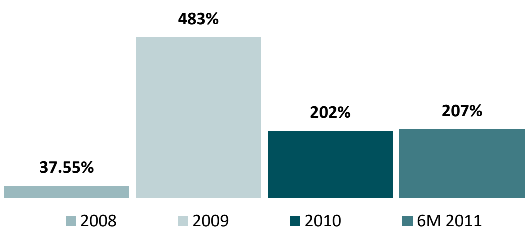
As revealed by the prior years' surveys, the nature of the main differences between Romanian GAAP and IFRS in the financial statements of banks refers to:

- Impairment of loans and advances to customers adjustments (IAS 39: Financial Instruments: recognition and measurements);
- Amortized cost adjustments (IAS 39: Financial Instruments: recognition and measurements);
- Deferred tax related adjustments (IAS 12: Deferred Tax);
- Fair value of financial instruments (IAS 39: Financial Instruments: Recognition and Measurement
- Other adjustments: Impairment of own land and Buildings (IAS 36), Employee benefits (IAS 19), Leases (IAS 17), amortized cost of financial liabilities (IAS 39), Restatement adjustments required in accordance with IAS 29 (Financial Reporting in Hyperinflationary Economies), Functional currency related adjustments (IAS 21: The Effects of Changes in Foreign Exchange Rates)

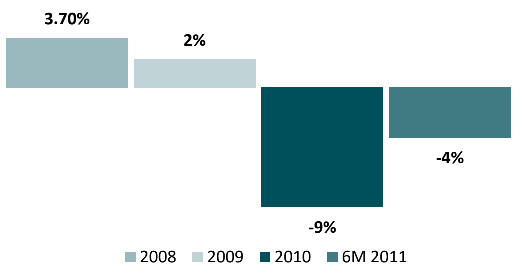
The effect of the above mentioned difference is showed in the next page/below.

The following graphs depict the percentage of IFRS differences as compared to statutory results of the period (profit or loss in absolute terms).

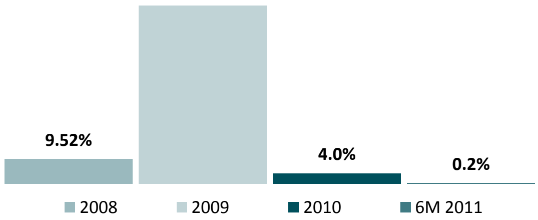
Impairment of loans and advances



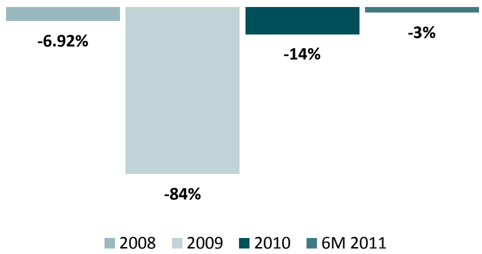
Fair value adjustments



Amortized cost measurement



Deferred tax adjustments



Legend: Y axis represents the percentage of IFRS difference from statutory profit (loss is presented in absolute terms).

IV. Main differences between Romanian GAAP and IFRS

Serban Toader: " One of the most challenging duty of the management of the banks is to keep the proper balance between the capital position both in the eyes of the shareholders in terms of investment return and in the eyes of the regulators in terms of capital adequacy from prudential requirements and also the initial tax position."

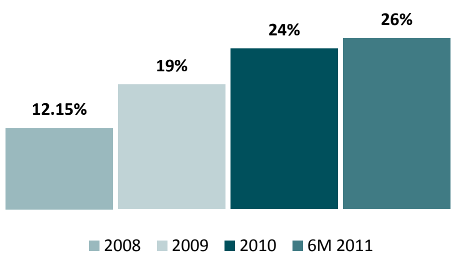
Financial statements of banks

Impact on equity

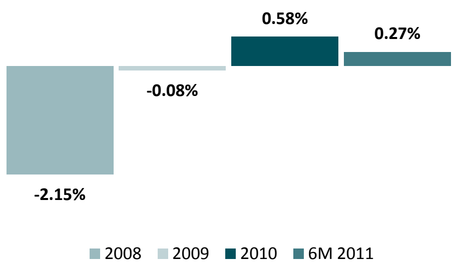
- As revealed by tImpairment of loans and advances to customers adjustments (IAS 39: Financial Instruments: recognition and measurements)
- Amortized cost adjustments (IAS 39: Financial Instruments: recognition and measurements)
- Deferred tax related adjustments (IAS 12: Deferred Tax)
- Fair value of available for sale financial instruments (IAS 39: Financial Instruments: recognition and measurements)
- Other adjustments: (Employee benefits (IAS 19), Leases (IAS 17), amortized costs of financial liabilities (IAS 39), Restatement adjustments required in accordance with IAS 29 (Financial Reporting in Hyperinflationary Economies), Functional currency related adjustments (IAS 21: The Effects of Changes in Foreign Exchange Rates).

The following graphs shows the percentage of IFRS differences as compared to statutory equity of the period.

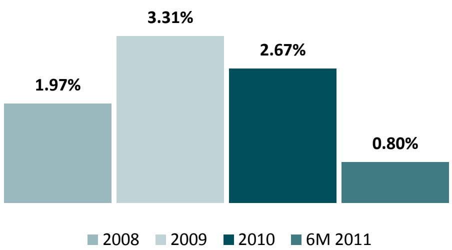
Impairment of loans and advances



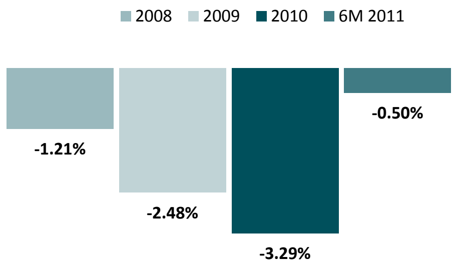
Fair value adjustments



Amortized cost measurement



Deferred tax adjustments



Legend: Y axis represents the percentage of IFRS difference from statutory equity.

Results of the survey

The survey revealed that certain differences exceeded the 5% threshold identified in our previous years' reports and these mainly relate to loan impairment provisions and the fact that the banks' results significantly decreased in 2010. At the end of 2010, 13 of the 22 banks in our study registered loss under Romanian GAAP reporting framework, at the end of 2009, only 8 out of 19 banks in our study reported loss under Romanian GAAP reporting framework.

The survey revealed that the differences in total profit or total equity between IFRS and Romanian GAAP continued the ascending trend, observed in the previous periods, mainly through impairment provisions for deteriorating quality of loan portfolios.

IV. Main differences between Romanian GAAP and IFRS

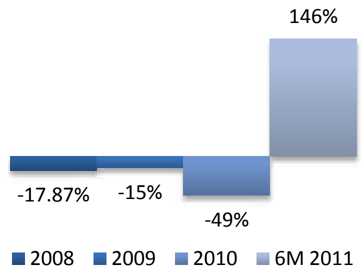
Financial statement of Non-Banking Financial Institutions

The results of the survey show that, there are still differences between the national framework and IFRS, such as impairment of loans and advances to customers, amortized cost and deferred tax. In 2010, and continuing in the first half of 2011, the impairment provision adjustments showed a high negative impact both on the statutory profit and loss account and equity (as presented below), mainly due to the continued deterioration of the collaterals and the client creditworthiness. Another factor significantly influencing the statutory results was the increase in the contract early cancellation and the impairment of the recovered collateral.

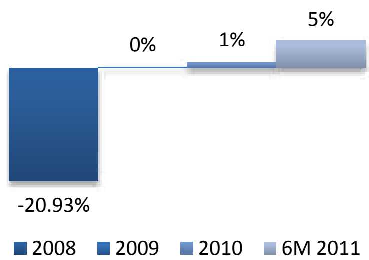
Please refer to each individual section for further interpretations.

Impact on profit or loss

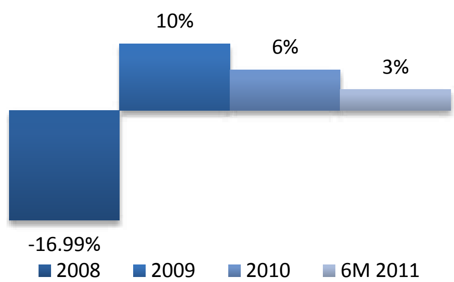
Impairment of loans and advances to customers



Amortized cost measurement



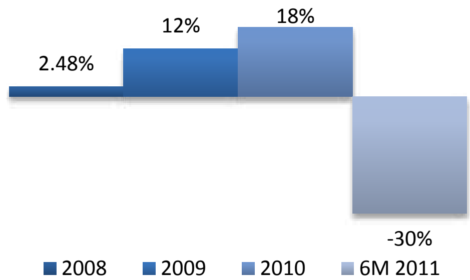
Deferred tax impact



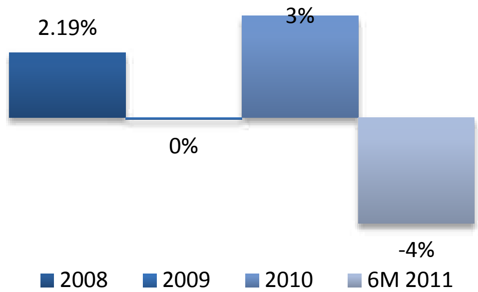
Impact on equity

Capitalization could be a more important challenge for Non banking financial institutions , given less complex solvency requirements.

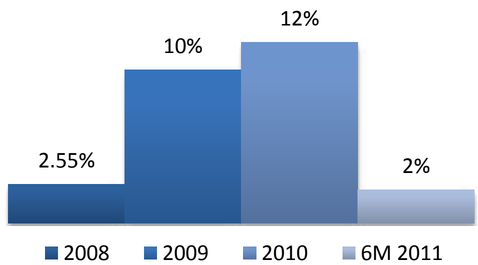
Impairment of loans and advances to customers



Amortized cost measurement



Deferred tax impact



Legend: Y axis represents the percentage of IFRS difference from statutory equity.

Our Financial Services Management Team

From left to right:

Diana Muresan, Manager
Marinela Grigore, Manager
Cezar Furtuna, Partner
Serban Toader, Senior Partner
Tudor Grecu, Director
Irina Rubeli, Manager
Ana Marin, Manager

Our Financial Services team comprises more than 80 professionals, with high levels of knowledge, expertise and technical skills

V. Impairment of loans and advances to customers

The difficult economic conditions made visible its effects on the debtors' financial behavior, leading to increase of the non-performing loans rate (defined as the total gross exposure of the loans classified as loss 2 and the debt service over 90 days, of total balance sheet gross exposure) to 14.18 percent as of 30 September 2011, 11.85 percent as of 31 December 2010. The average capitalization ratio for the banking sector was 14.19 percent at end-June 2011, showing a decrease compared with December 2010, 15.02 percent.

Financial statements of banks

During the previous year study we noted that the cases where the banks showed losses under Romanian GAAP and profits under IFRS were not longer a common situation but rather exceptions. This year study confirmed the conclusions from the previous year, however, in 2010, half of the banks sampled registered losses under IFRS (in 2009, only 5 banks out of 19 registered losses under IFRS).

> "Romanian banks need also to understand that the IFRS methodology is continuously changing."

In 2010, the differences between banks' financial reporting under IFRS compared with Romanian GAAP continued the ascending trend, mainly due to the increase in discrepancy between the loans loss provisions level under IFRS and Romanian GAAP.

Romanian GAAP generally makes greater provision for bad loans than IFRS, and so tends to present a more conservative picture of a company's financial situation.

An analysis of the impact on the banks in our study (please see the graphics below) revealed that the adjustment referring to the impairment of loans and advances to customers had a higher than 5% impact on profit and a higher than 5% impact on equity for the majority of the banks included in the study, as follows:

- As at 31 December 2008, the study revealed that for 86% of the banks included in the study the adjustments related to the impairment of loans and advances to customers had a high impact on equity and for 50% of the banks included in the study, a higher impact on profit.
- As at 30 June 2009, this result was observed for 89% of the banks for impact on profit and for 78% of the banks for the impact in equity.
- As at 31 December 2009, this result was observed for 89% of the banks for impact on profit and for 58% of the banks for the impact in equity
- As at 30 June 2010, this result was observed for 91% of the banks for impact on profit and for 70% of the banks for the impact in equity
- As at 31 December 2010, this result was observed for 86% of the banks for impact on profit and for 82% of the banks for the impact in equity
- As at 30 June 2011, this result was observed for 90% of the banks for impact on profit and for 87% of the banks for the impact in equity

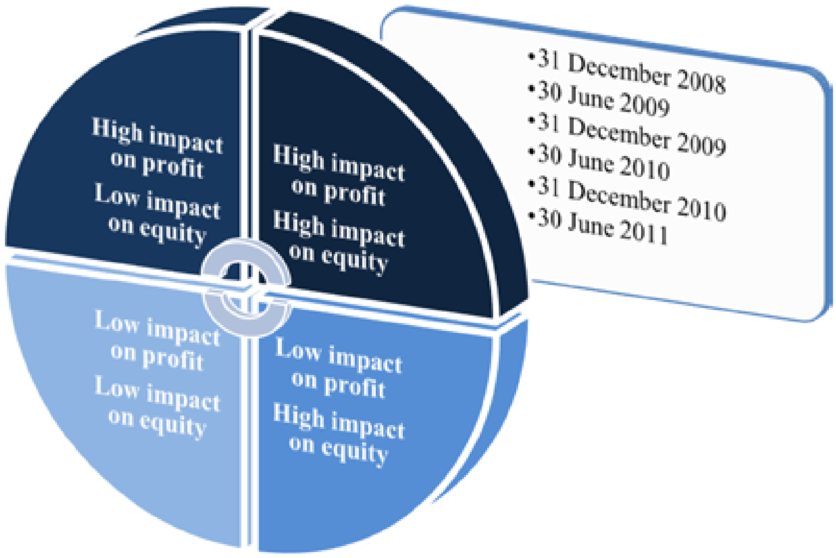
RAS vs. IFRS

The significant difference between the adjustments for depreciation of loans calculated on the basis of IFRS principles and the adjustments for depreciation of loans calculated on the basis of NBR applicable accounting regulations has probably been the most controversial aspect.

Besides the difficulty of adopting the "incurred loss" model, parameters and new concepts like the probability of loss and collective provisioning, all of which are challenging by themselves, the true challenge starts from the foundation of this methodology. The provisioning methodology specified in IAS 39 is not normative, in opposition to the existing specifications of the National Bank of Romania included in Regulation no. 3/2009.

The IFRS approach emphasizes professional judgment which is crucial in estimating many factors used in provisions calculation, which leads to a high degree of subjectivity. Loans' impairment provisions were named by the president of the Romanian Banks Association ("ARB"), Radu Gratian Ghetea, as "the apple of discord" in the trilateral negotiations between the ARB, the NBR and the Ministry of Public Finance ("MFP"). As such, the banks need to develop not only the methodologies which are in accordance with IFRS general principles, but also systems for provisions ratification (back testing, stress-testing, etc.) able to reduce or correct the element of subjectivity.

Romanian banks, used to the matrix calculation method specified in the statutory Romanian regulations, need also to understand that the IFRS methodology is continuously changing. New information can become available and able to indicate the depreciation of a part of the portfolio or the need for an additional segmentation, parameters need to be permanently updated and, at the same time, banks need to establish the extent to which the historical reality matches with the actual context. Banks should permanently verify whether the parameters obtained on the basis of historical data need to be adjusted to reflect recent developments more closely.



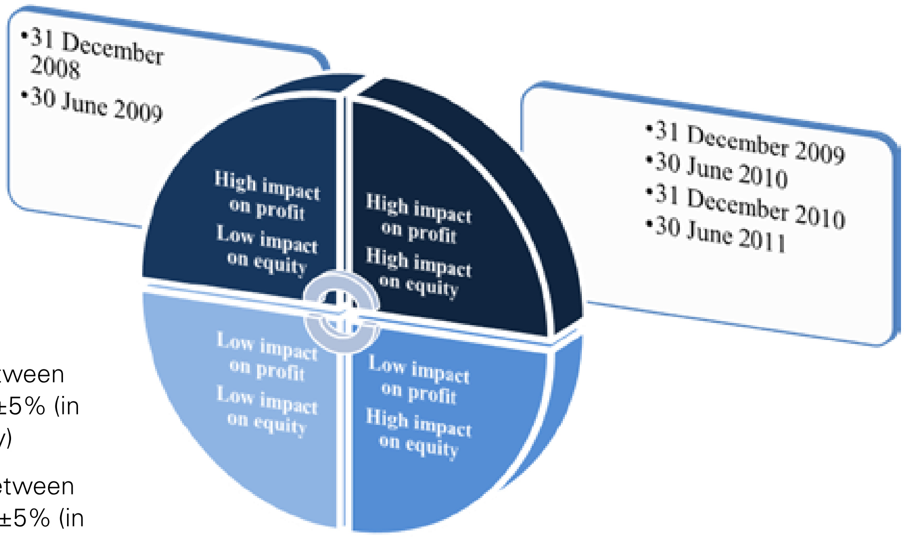
Legend

- Higher impact on profit- differences between IFRS and statutory profit of more than ±5% (in terms of number of entities in our study)
- Higher impact on equity- differences between IFRS and statutory equity of more that ±5% (in terms of number of entities in our study.

V. Impairment of loans and advances to customers

Financial statement of Non-Banking Financial Institutions

This year survey related to the financial statements of non-banking financial institutions revealed that for the six months ended 30 June 2011 for 100% of the non-banking financial institutions included in the study (for the year ended 31 December 2010: 92%, 31 December 2009: 71%, 31 December 2008: 56%), the adjustments related to the impairment of loans and advances to customers had a higher impact on profit. With regards to the impact on the equity, 100% of the non-banking financial institutions as of 30 June 2011 (31 December 2010: 85%; 31 December 2009: 86%; 31 December 2008: 47%) showed higher impact of the adjustment related to the impairment of loans to the equity of the companies.



Legend

- Higher impact on profit- differences between IFRS and statutory profit of more than ±5% (in terms of number of entities in our study)
- Higher impact on equity- differences between IFRS and statutory equity of more that ±5% (in terms of number of entities in our study.

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Legal services

The "New Civil Code", effective 1 October 2011, has a significant and immediate impact on the financial services sector.

The New Civil Code brings radical novelties and fully replaces the 1864 Civil Code, by also consolidating doctrine and case law. It is crucial for all financial services entities to promptly re-address key legal risks and reconsider major aspects of their legal documentation, starting from offerings and negotiation to standard agreements.

The contractual documentation and the risks related to contract execution and performance have to be tailored to reflect the new regulations on adhesion contracts, standard and atypical clauses, statute of limitation, termination, damages and related penalties, guarantees, banking contracts etc.

In light of the above, our associated lawyers can help you manage the legal risks, stay compliant and be well protected while pursuing successful business goals:

- drafting tailored best practice contractual documentation
- advice on legal risk compliance
- comprehensive general business terms, special terms and standard financial contracts
- conformity review of ongoing contracts and compliance upgrade according to the New Civil Code
- legal solutions for various types of products and contracts designed for various categories of clients
- protective clauses (liability, group exposures, foreclosure etc)
- review of collaterals documentation and advice on protection of priority ranks
- legal due diligence of debtors (ownership titles, corporate compliance, contracts, litigation etc)
- legal assistance regarding project finance and debt restructuring
- debt collection and insolvency
- dispute resolution

Our lawyers are business-oriented advisors with legal and financial background, with strong negotiation skills and a result-driven approach. Having a thorough understanding of the specifics of financial services, our professionals offer uniform quality, observe tight deadlines, anticipate clients' needs and meet their requirements with professionalism and proficiency.

Contact:
Daniela Nemoianu
Executive Partner
dnemoianu@kpmg.com

VI. Amortized cost measurement

Romanian GAAP - NBR Order 5/2005 with subsequent amendments, from 1 January 2009, by NBR Governor's Order 13/2008

The current legislation allows banks and financial institution to choose between the linear and effective interest rate deferral of the origination commissions. From the presentation point of view, following the Romanian GAAP requirements, the origination commissions are mapped to other assets, not together with the financial assets related.

> **"The stipulations of the NBR order 27/2010 raised controversies with regards to the unwinding of interest effect estimation."**

IFRS - IAS 39 Financial Instruments: Recognition and Measurements and IAS 18 Revenues

According to IFRS, the amortized cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between the initial amount recognized and the maturity amount, minus any reduction for impairment. Interest income and expenses are recognized in the income statement at amortized cost using the effective interest rate method.

Looking into the near future, the NBR Order 27/2010 which will enter in force on 1 January 2012, came with clear stipulations regarding the amortized cost of the loans and advances to customers:

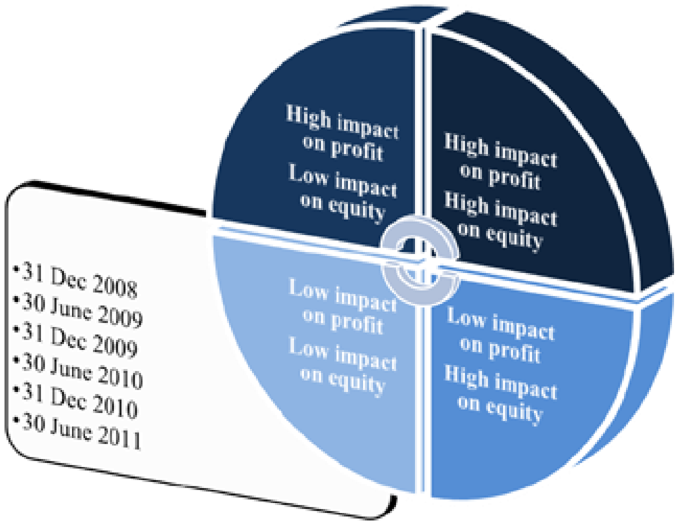
- mandatory utilization of effective interest rate method in determining the amortized cost;
- mandatory accounting and presentation of the contractual interest for all the loans in the portfolio, including loans granted to customers with impairment indicators;
- unwinding of interest, which leads to interest correction for impaired loans

The stipulations of the aforementioned NBR order raised controversies with regards to the unwinding of interest effect estimation. Although, these requirements are not new from IFRS point of view, the method of estimation used by the banks differ from the stipulations of the aforementioned NBR order: stop accrual method for the impaired loans was used by several banks in the banking system (included also in our study) in order to estimate at the best the amortized cost of the loans.

Financial statements of Banks

Effective interest rate had a lower impact on profit and a lower impact on equity due to incorporation of effective interest rate requirements in Romanian GAAP and also due to the low differences between the effective interest rate and linear method:

- As at 31 December 2008, this result was observed for 71% of the banks for impact on profit and for 100% of the banks for the impact on equity
- As at 30 June 2009, this result was observed for 78% of the banks for impact on profit and for 89% of the banks for the impact on equity
- As at 31 December 2009, this result was observed for 79% of the banks for impact on profit and for 89% of the banks for the impact on equity
- As at 30 June 2010, this result was observed for 73% of the banks for impact on profit and for 90% of the banks for the impact on equity
- As at 31 December 2010, this result was observed for 77% of the banks for impact on profit and for 91% of the banks for the impact on equity
- As at 30 June 2011, this result was observed for 100% of the banks for impact on profit and for 100% of the banks for the impact on equity



Legend

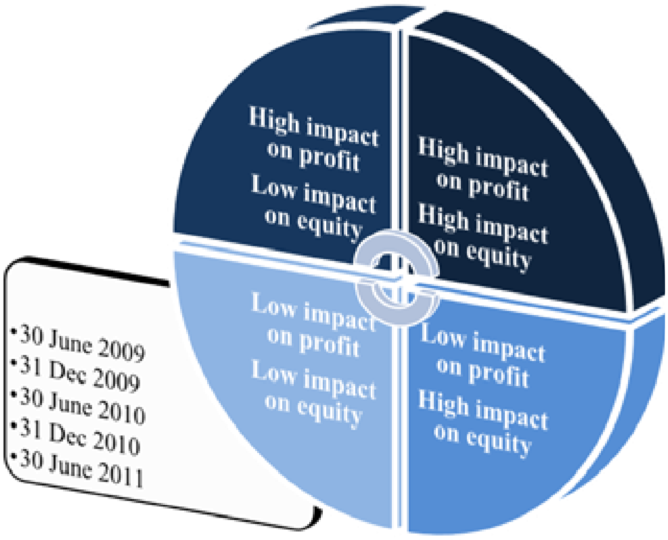
- Higher impact on profit- differences between IFRS and statutory profit of more than ±5% (in terms of number of entities in our study)
- Higher impact on equity- differences between IFRS and statutory equity of more that ±5% (in terms of number of entities in our study.

> “Few non-banking financial institutions have incorporated the effective interest rate measurement into statutory financial statements.”

Financial Statements of Non-Banking Financial Institutions

The study revealed that for the six months ended 30 June 2011, for 75% (for the year ended 31 December 2010: 77% while for the year ended 31 December 2009: 93% and for the year ended 31 December 2008: 56%) of the non-banking financial institutions included in the study the adjustments related to the amortized cost measurement had a low impact on profit. For the same period, for 75% (31 December 2010: 85%; 31 December 2009 - 93%; 31 December 2008 - 76%) of the non-banking financial institutions included in the study these adjustments had a lower impact on equity.

As no specific requirements regarding the convergence of the non-banking financial institutions financial statements to IFRS, most non-banking financial institutions, the process is still its initial phase and few non-banking financial institutions have incorporated the effective interest rate measurement into statutory financial statements. However, as revealed by this survey, the difference between the two treatments does not have a significant impact either on the profit or the equity.



Legend

- Higher impact on profit- differences between in IFRS and statutory profit of more than ±5% (in terms of number of entities in our study)
- Higher impact on equity- differences between IFRS and statutory equity of more that ±5% (in terms of number of entities in our study.

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ADVISORY

KPMG Restructuring

In a rapidly changing marketplace, today's success stories can be tomorrow's casualties. Globalization often requires businesses and their stakeholders to operate in unfamiliar circumstances with hugely diverse regulatory environments. Meanwhile, the need for businesses to innovate is resulting in ever more complex financing structures, provided by an increasing number and variety of financial stakeholders.

Our Restructuring professionals have extensive experience in steering stresses and distressed businesses towards a stronger position.

Our services include:
Turnaround planning and implementation
Exit planning and implementation
Debtor, creditor or court driven formal restructurings
Financial restructuring
Cash management
Cost optimisation

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Speranta Munteanu
Partner, Restructuring
smunteanu@kpmg.com

kpmg.ro

VII. Fair value of financial instruments

Financial statements of banks

The main difference between Romanian GAAP ("RAS") and IFRS in terms of fair value of financial instruments is that, except for trading portfolios, the increases in fair value are not allowed to be recognized in statutory financial statements, while decreases should always be provided for. Consequently, when quoted market prices decreased while interest rates for treasury bills increased, and the variations proved to be prolonged and significant, the differences between IFRS and statutory accounts were smaller.

> **"As the global financial market is in continuous change the need of transparent and clear reporting is increasing."**

The study revealed that the adjustment referring to the fair value of financial instruments had a lower impact on profit and a lower impact on equity for the majority of the banks included in the study, as follows:

- As at 31 December 2008, the study revealed that for 79% of the banks included, the differences related to fair value adjustments on financial instruments had less than ±5% impact on profit and for 86% them an impact on profit of less than ±5%.
- As at 30 June 2009, this result was observed for 56% of the banks for impact on profit and for 100% of the banks for the impact on equity
- As at 31 December 2009, this result was observed for 68% of the banks for impact on profit and for 95% of the banks for the impact on equity
- As at 30 June 2010, this result was observed for 73% of the banks for impact on profit and for 100% of the banks for the impact on equity.
- As at 31 December 2010, this result was observed for 77% of the banks for impact on profit and for 91% of the banks for the impact on equity
- As at 30 June 2011, this result was observed for 100% of the banks for impact on profit and for 100% of the banks for the impact on equity.

IFRS

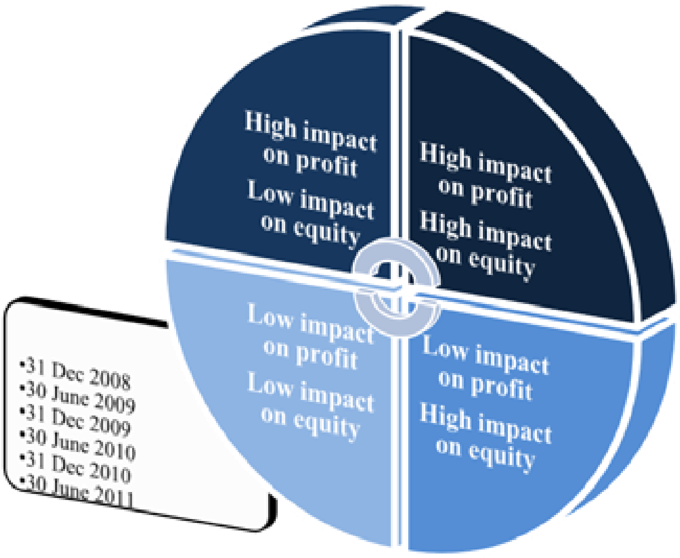
IAS 39 Financial instruments: Recognition and measurement and IFRS 7 Financial Instruments: Disclosure

A gain or loss on an available-for-sale financial asset is recognized in equity, except for impairment losses and foreign exchange gains and losses until the financial asset is derecognized. Similarly to Romanian GAAP, IFRS requires that financial instruments held at fair value through profit or loss should be measured at fair value, with the effect of any gains/losses in the Profit and Loss account.

As the global financial market is in continuous change, facing more and more challenges in terms of risks, the need of transparent and clear reporting is increasing. The international financial framework continuously adapts its' regulations in order to meet the need of transparency and comparability of the financial information. Starting with 2008, and continuing with 2009, 2010 and 2011, the International Financial Reporting Standards which regulates the financial instruments were in continuous transformation.

On 12 May 2011 the IASB issued IFRS 13 Fair Value Measurement. IFRS 13 defines fair value, sets out in a single IFRS a framework for measuring fair value and requires disclosures about fair value measurements. IFRS 13 applies when other IFRSs require or permit fair value measurements. It does not introduce any new requirements to measure and asset or a liability at fair value, change what is measured at fair value in IFRSs or addresses how to present changes in fair value.

The new requirements are effective for annual periods beginning on or after 1 January 2013, with earlier application permitted.



Romanian GAAP

NBR Regulation 5/2002 with subsequent amendments, replaced on 19 March 2009 by NBR regulation 3/2009 with subsequent amendments, NBR Order 13/2008 with subsequent amendments

Order 13/2008 applicable to banks and non-banking financial institutions stipulates that unrealized gains on available for sale instruments are only to be disclosed in the notes to financial statements. The unrealized losses on available for sale instruments will adjust their value.

Romanian GAAP does not make a clear reference as to whether negative losses on available for sale financial instruments are to be recorded in equity before there is objective evidence of impairment in the profit and loss account. In addition, BNR Order 13/2008 requires the measurement of held for trading treasury bills and derivative instruments at fair value, with the effect of any gains/losses being shown in the Profit and Loss account.

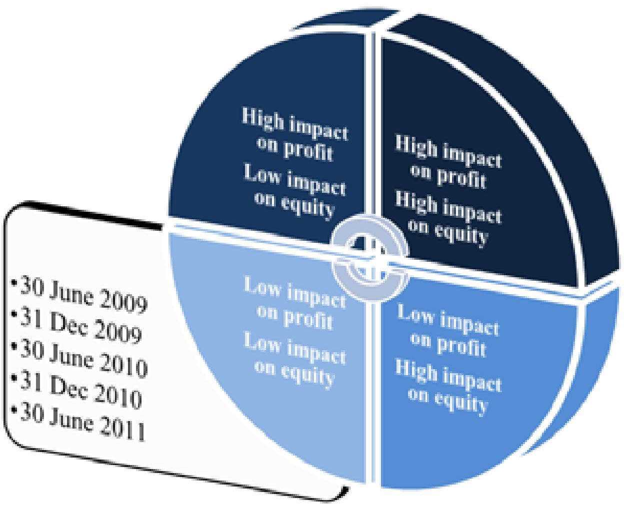
A look into the near future: Starting 1 January 2012, the stipulations of NBR Order 27/2010 will enter in force, as the statutory accounting will align with the IFRS requirements. In this respect, the major change related to financial instruments is the accounting of both gains and losses from available for sale classified financial assets into other comprehensive income.

Legend

- Higher impact on profit- differences between IFRS and statutory profit of more than ±5% (in terms of number of entities in our study)
- Higher impact on equity- differences between IFRS and statutory equity of more that ±5% (in terms of number of entities in our study.

Financial Statements of Non-Banking Financial Institutions

As concluded in the previous year study, the current year study did not revealed a high impact on the profit or on the equity of the non-banking financial institutions, related to fair value of financial instruments adjustments. This instance is mainly due to the fact that the companies included in the study either hold no significant financial instruments classified in IFRS in the fair value categories, or they hold derivative financial instruments for risk management purposes, for which valuation principles and accounting rules are similar in the two reporting frameworks.



VIII. Deferred tax adjustments

Financial statements of banks

The study revealed that the deferred tax related adjustments required in accordance with IAS 12 had an increasing impact on profit and a lower impact on equity for the majority of the banks included in the study, as follows:

- As at 31 December 2008, the study revealed that for 71% of the banks included in the study the adjustments related to deferred tax had a lower impact on profit and for 93% of the banks, lower or no impact on equity
- As at 30 June 2009, this result was observed for 44% of the banks for impact on profit and for 78% of the banks for the impact in equity
- As of 31 December 2009 a high impact on profit was observed for 58% and a low impact on equity was observed for 79% of the banks in our sample.
- As of 30 June 2010 the same high impact on profit was observed for 55% and a low impact was observed for equity for 80% of the banks in our sample
- As of 31 December 2010 a high impact on profit was observed for 58% of the banks and for 77% of the banks in our sample we observed a low impact on equity
- As of 30 June 2011 a low impact on profit was observed for 63% of the banks and for 88% a low impact on equity.

IFRS

IAS 12 Deferred tax

The tax base is the accounting profit. Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of goodwill, the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they probably will not reverse in the foreseeable future.

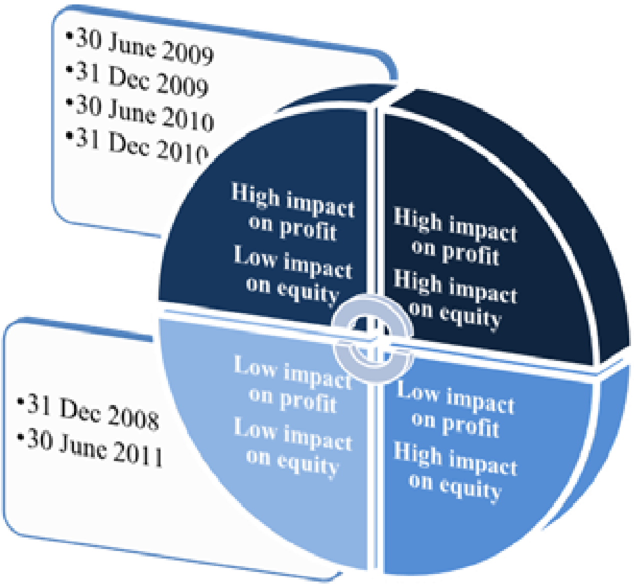
Deferred tax is measured at the tax rates, which are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be used.

Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Romanian GAAP

NBR Order 5/2005 with subsequent amendments, superseded from January 1, 2009, by NBR Governor Order 13/2008

The tax base is the fiscal profit. In addition, until 2007, Romanian GAAP applicable to banks and non banking financial institutions allowed the recognition of deferred tax. Starting with the 2007 financial year, NBR Order 5 does not allow the recognition of a deferred tax asset or liability.

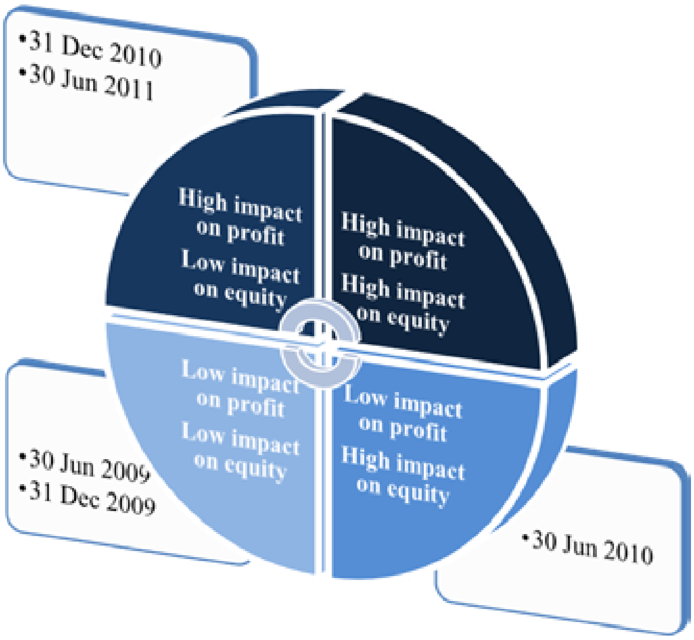


Legend

- Higher impact on profit- differences between IFRS and statutory profit of more than ±5% (in terms of number of entities in our study)
- Higher impact on equity- differences between IFRS and statutory equity of more that ±5% (in terms of number of entities in our study..

Financial Statements of Non-Banking Financial Institutions

This year study showed that the deferred tax related adjustments required in accordance with IAS 12 had a higher impact on the profit (62% of the non-banking institutions in our sample) and a lower impact on the equity (54%) for 31 December 2010 financial statements. The same situation was observed for 30 June 2011: higher impact on the profit for 75% of the non-banking financial institutions in our sample and lower impact on equity for 75% of the non-banking financial institutions in our sample. In the prior year studies, we identified lower impact on profit in 2009 for 64% (2008: 78%) of the non-banking financial institutions included in the study, and a lower impact on equity for 57% of the non-banking financial institutions included in the study.



Legend

- Higher impact on profit- differences between IFRS and statutory profit of more than ±5% (in terms of number of entities in our study).
- Higher impact on equity- differences between IFRS and statutory equity of more that ±5% (in terms of number of entities in our study.

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Financial risk management

Overall concerns about risk and uncertainty have been increasing at a rapid pace in the past few months. In this adverse climate, credit institutions must have robust risk management frameworks that satisfy regulatory demands, contribute to better decision making and enhance performance. Our FRM team is prepared to support your organization in facing complex risk management issues.

Our FRM expertise focuses on the following areas:

ICAAP review & enhancement services
Internal Audit support for ICAAP reviews
Development of Pillar 2 internal capital models
Overall risk management framework review
Liquidity risk management (including scenario analysis & contingency plans)
Stress testing framework review
Basel II Internal Rating Based (IRB) advisory services
Review & validation of internal rating models
Development of derivatives hedging strategies
Derivatives structures and pricing independent reviews
Hedge accounting services under IAS 39 (including macro-hedging)
Risk management training

Contact:
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Senior Manager
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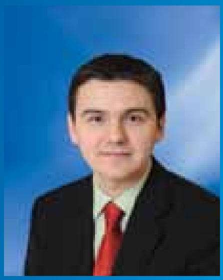

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Applying Tax rules

Manage conversion effectively together with your KPMG specialist

As the deadline for banks' IFRS conversion is near, there is still a high degree of uncertainty regarding the applicable tax rules for determining the IFRS conversion impact for all the items recorded in the credit institutions' financial statements, despite the preliminary guidelines issued by the Romanian tax authorities and the discussions held with the banks representatives.

Considering the high amounts at stake, KPMG may assist credit institutions in the process of identifying the tax impact of IFRS conversion adjustments. We can help insure that the issues are identified in due time and can share leading practices to help avoid the many pitfalls of such projects.

In addition, we may offer training programs targeted at preparing the Accounting and Finance personnel for the new tax rules (including deferred tax calculation, estimating the conversion's tax impact for each category of items).

Our team has helped many companies, both Romanian and foreign, to achieve operational, organizational and service excellence – ultimately strengthening their position in this challenging context. We look forward to doing the same for your organization. We are committed to providing a structured approach with the aim of delivering consistent, high-quality services.

Mark Gibbins
Partner, Head of Taxation Services
mgibbins@kpmg.com


Turning complexity into opportunity
Reaching your goals in a complex environment requires a clear focus aligned with an adaptable strategy. That's the kind of leadership Phil Mickelson brings to a golf course. And KPMG brings to its clients.
What's the mark of a leader? Find out from Phil. Hear the stories behind the leading moments in his career at phil.kpmg.com
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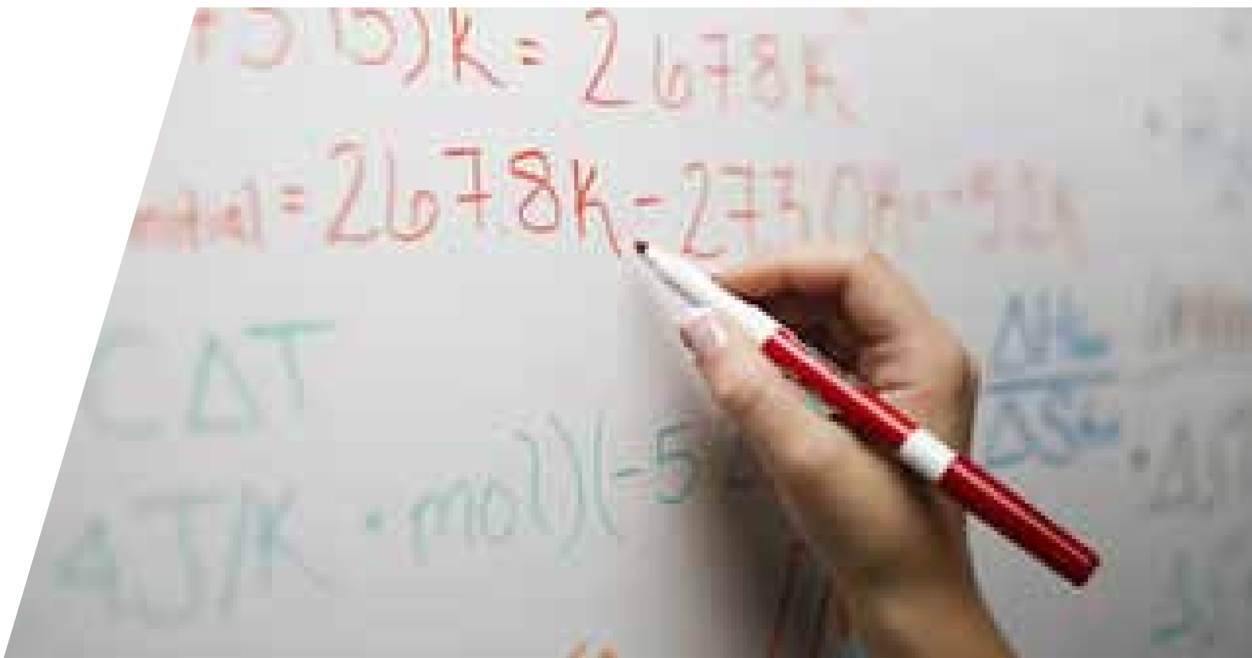
IX. Other adjustments

Description	Romanian GAP	IFRS	Impact on Profit	Impact on Equity
Restatement adjustments required in accordance IAS29 ("Financial Reporting in Hyperinflationary Economies")	There is no reference in Romanian GAAP applicable to banks, to a restaurant requirements, in hyperinflationary economies	According to IAS 29 and IAS 21, the financial statements of an enterprise whose functional currency is the currency of hyperinflationary economy should be stated in terms of measuring unit current at the balance sheet date i.e. non monetary items are restated using e general price index, from the date of acquisition or contribution	low	Low
Impairment of non-financial assets in accordance with IAS 36 ("Impairment of Assets").	Impairment testing should be performed but no specific requirements on the methods of establishing recovering amounts	IAS 36 has specific requirements on how the impairment testing should be performed, using discounted expected cash flows on each cash generating unit, for computing the value in use, or fair value less cost to sell.	low	low
Functional currency adjustments.	NBR Order 5/2005 applicable to banks and non-banking financial institutions stipulates that the functional currency is the national currency	Requires the measurement of profit using the functional currency defined as the currency of primary economic environment in which the entity operates. However, entities may present financial statements in a different currency.	low	low
Employee benefits - defined benefit plans	Defined benefit plans are not used in practice and are not regulated by any standard	IAS 19 - Employee benefits - Must use projected unit credit method to determine benefit obligation	low	low
Employee share compensation	No guidance on recognition or measurement of items. Disclosure of compensation for Members of the Board of Directors, Supervisory Board and executives is required	IAS 19 and IFRS 2 - Share based payment , Disclosures required , guidance or proposal on recognition or measurement	low	low
Employee benefits – other	Post - requirement benefits is not covered by standards. In practice usually accounted for on cash flow basis. Establishing of provisions for post-employment benefits.	IAS 19 - Account for post retirement benefits as pensions. Rules also given for termination benefits arising from redundancies and other post-employment and long-term employee benefits. Account for termination indemnity plans as pensions	low	low
Finance charges on borrowings	Comparable to IFRS starting from 2007	IAS 39 - Financial Instrument. Recognition and measurement - Interest expense recognized on an accrual basis. Effective yield methods used to amortize all financial changes.	low	low
Adjustment to the profit and loss account in accordance with the accrual principle	Revenues and costs are recognized as they are named or incurred under the accrual basis of accounting. The net profit for each period should reflect that period's transactions, events and circumstances	IAS 1 - Presentation of Financial Statements - Similar; differences from Romanian GAAP due to the appropriate timing of recognition and measurement on the accrual basis.	low	low

X. Presentation and structure of financial reporting

	Romanian GAAP	IFRS
Presentation Currency	Only the national currency	Entities may presented financial statements in any currency and provides guidance on how translate from its functional currency (when different than presentation currency)
Balance sheet (Statement of financial position) and Income statement (Statement of Comprehensive Income) format	A prescribed standard format and structure	Does not prescribe a particular format: an entity uses a liquidity presentation of assets and liabilities, instead of a current/non current presentation, only when a liquidity presentation provides more relevant and reliable information. Certain items must be presented on the face of the statement of financial position.
An entity can choose between two versions of presentation for the Statement of comprehensive income.	NBR Order 5/2005 applicable to banks and non-banking financial institutions stipulates that the functional currency is the national currency	Requires the measurement of profit using the functional currency defined as the currency of primary economic environment in which the entity operates. However, entities may present financial statements in a different currency.
Exceptional items	General requirement for the explanation of material items presented in the financial statements, although it is not permitted to supplement the prescribed format in the primary structure.	Requires separate disclosure of items that are of such size, incidence (impact) or nature that they require separate disclosure to explain the performance of the entity. These items must be presented either on the face of the statement of financial position, on the face of the statement of comprehensive income or included within the notes.
Other statements (format and method)	A standard format for basic categories of cash flows, using the indirect method (from operating, investing and financial activities).	Standard heading, but limited flexibility of contents. Use direct or indirect method for the statement of cash flows.



XI. Disclosure requirements

Description	Romanian GAAP	IFRS
Summary of fair value of assets and liabilities.	Not specifically required as a separate disclosure note but required for certain positions from the financial statements to be presented in the notes i.e. positive fair value amounts for positive value on available for sale instruments.	Mandatory under IFRS 7"Financial Instruments Disclosures"
Qualitative disclosures: • Risk exposures for each type of financial instrument • Management's objectives, policies and processes for managing these risks • Changes from the prior period	Not specifically required but recommended and presented as an example of disclosure information for certain balance sheet positions ,required in the Management Report which accompanies the financial statements. In addition, the banks prepare separate prudential reports to the National Bank of Romania.	Mandatory under IFRS 7"Financial Instruments Disclosures"
Concentration of risk	Not specifically required but recommended and presented as an example of disclosure information for certain balance sheet positions, required in the Management Report which accompanies the financial statements. In addition, the banks prepare separate prudential reports to the National Bank of Romania.	Mandatory under IFRS 7"Financial Instruments Disclosures"
Credit Risk	Not specifically required but recommended and presented as an example of disclosure information for certain balance sheet positions, required in the Management Report which accompanies the financial statements. In addition, the banks prepare separate prudential reports to the National Bank of Romanian.	Mandatory under IFRS 7"Financial Instruments Disclosures". • Maximum amount of exposure before deducting the value of collateral, description of collateral, Information about credit quality of financial assets that are neither past due nor impairment and information about credit quality of financial assets whose terms have been renegotiated • For financial assets that are past due or impairment, analytical disclosures are required
Liquidity Risk	Not specifically required but recommended and presented as an example of disclosure information for certain balance sheet positions, required in the Management Report which accompanies the financial statements. In addition, the banks prepare separate prudential reports to the National Bank of Romania.	Mandatory under IFRS 7 "Financial Instruments Disclosures": • A maturity analysis of financial liabilities • Description of approach to risk management
Market risk	Not specifically required but recommended and presented as an example of disclosure information for certain balance sheet positions, required in the Management Report which accompanies the financial statements. In addition, the banks prepare separate prudential reports to the National Bank of Romania.	Mandatory under IFRS 7"Financial Instruments Disclosures": • Sensitivity analysis of each type of market risk to which the entity is exposed • iFRS 7 provides that if an entity prepares a sensitivity analysis for management purposes that reflects interdependencies of more than one component of market risk (for instance, interest risk are foreign currency risk combined),it may disclose that analysis instead of a separate sensitivity analysis for each type of market risk.

XII. Tax impact on the main conversion adjustments

In order to be well-prepared for adopting IFRS as of 1 January 2012, the credit institutions need to assess the potential tax impact of the conversion at least for each of the following items: impairment on loans and advances to customers, operations with financial instruments, fixed assets.

Impairment on loans and advances to customers (IAS 39

The adjustments to be made by credit institutions to credit risk provisions further to adopting IFRS are most likely to generate the highest tax impact (in comparison with all the other adjustments). Until a final decision is made by the tax authorities, several alternatives are still discussed.

If provisions set up under IFRS are accepted also for tax purposes, the adjustment may lead to significant taxable revenue being booked at conversion. Should this be the alternative chosen, the tax impact related to conversion may be deferred over one or more tax periods (most likely 1-2 years).

Under a different approach, provisions set up under IFRS would not be recognized for tax purposes (therefore generating non-deductible expenses and non-taxable revenues), while the level of regulatory (prudential) credit risk provisions would be used for tax purposes.

Financial instruments

Financial assets and liabilities classified at fair value through profit or loss. If the current tax treatment is maintained, tax adjustments would not be necessary at the moment of conversion to IFRS. However, off balance-sheet evidence would need to be kept by credit institutions so as to determine the gain/loss at the moment of sale (assignment) and a deferred tax would be recognized in relation to such instruments.

Financial assets and liabilities classified as available for sale. If the current tax treatment is maintained, tax adjustments would not be necessary at the moment of conversion to IFRS. Deferred tax would be recognized in relation to subsequent revaluation either in equity or in profit or loss, as applicable.

Fixed assets (IAS 16)

In relation to conversion to IFRS, there may be an impact related to fixed assets both at the level of profit tax and at the level of the tax on buildings due by credit institutions depending on the models chosen to be used by the management. Irrespective of the model applied, the tax treatment of impairment losses should remain constant (i.e. non-deductible for tax purposes).

The current conditions for applying increased tax rates for non-revaluated buildings would need to be revised so as to take into account the potential tax implications further to applying the cost model under IFRS.

XIII. Looking forward… Basel III

Basel III proposals seek to strengthen the resilience of both the financial system and individual financial institutions

After the financial crisis, regulators and governments called for banks to hold much more capital to help disincentivise unnecessary risk-taking and protect banks from shocks in times of market stress. In response, the Basel Committee on Banking Supervision (BCBS) in December 2010 published Basel III proposals to strengthen the resilience of both the financial system and individual financial institutions. Changes to the definition and calculation of capital and liquidity requirements under Basel III will be impacted by, and have implications for, financial reporting.

At the macro prudential level, the Basel III reforms target system-wide risks that can build up across the banking sector, such as liquidity shocks and credit availability, as well as the pro cyclical amplification of these risks over time. At the micro prudential level, the goal of the revised regulations is to raise the resilience of individual banks to periods of stress by increasing the quality and quantity of both capital and the liquid assets held against a bank's risk-weighted assets. However, the published Basel III rules left open a number of proposals for further observation and consultation. In July 2011, the BCBS issued Basel III frequently asked questions (FAQs), which addressed emerging proposals, such as additional capital charges. The FAQs are intended to promote consistent global implementation of the framework by publishing additional interpretative guidance.

Further change will come as local policy-setting bodies translate Basel III recommendations into local regulatory requirements. The extent to which these changes may compliment or conflict with current and proposed accounting requirements under IFRS will depend on the timing and final detail of local regulatory implementation measures. Such measures can potentially result in continued duplicate reporting of similar information measured under two different bases, which can pose challenges for banks in terms of systems and people management, as well as the need to factor accounting treatments into capital planning.

Despite an increase in the ratio of non-performing loans (the level of this ratio being above the European and Central Asia region 12% for the first half of 2011), the banking sector remains liquid and well capitalized, while private sector credit growth has gradually returned. In July 2011 the international ratings agency Fitch Ratings improved Romania's sovereign rating to "investment grade". However, the alignment to the Basel III requirements and meeting 9% Tier One Capital by June 2012 will be a challenge for the Romanian Banks also, taking into consideration the structure of the Romanian banking assets (78% of the them are foreign funded, 7% are Branches of Foreign Bank, and 15% are either Romanian State controlled or Romanian Private founded).

XIV. New IFRS developments

Standard name	Short description	Key changes
IAS 19 Employee Benefits	On 16 June 2011 the IASB issued amendments to IAS 19 Employee Benefits. The amendments will improve the recognition and disclosure requirements for defined benefits plans. The new requirements are effective for annual periods beginning on or after 1 January 2013 with earlier application permitted.	• All actuarial gain and losses recognised immediately in other comprehensive income • Finance costs- revised basis of calculation • Additional disclosures for defined benefit plans • Amended definitions of short-term and other long-term employee benefits • Possible changes to timing of recognition of termination benefits
IFRS 13 Fair Value Measurement	On 12 May 2011 the IASB issued IFRS 13 Fair Value Measurement. IFRS 13 defines fair value, sets out in a single IFRS a framework for measuring fair value and requires disclosures about fair value measurements. IFRS 13 applies when other IFRSs require or permit fair value measurements. It does not introduce any new requirements to measure and asset or a liability at fair value, change what is measured at fair value in IFRSs or addresses how to present changes in fair value. The new requirements are effective for annual periods beginning on or after 1 January 2013, with earlier application permitted.	• General principles Fair value as an exit price. Three-level fair value hierarchy is extended to all fair value measurements. • Specific application principles: Financial assets and liabilities with offsetting risks – allows measurement of net exposures in limited circumstances. • Disclosures: Effect on profit or loss for recurring fair value measurements categorised within Level 3. Fair value hierarchy disclosures are extended to non-financial assets and liabilities measured at fair value
IFRS 10 Consolidated Financial Statements	On 12 May 2011, IASB has completed its improvements to the accounting requirements for consolidation, joint arrangements and off balance sheet activities by issuing IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interest in Other Entities. The IASB also amended and renamed IAS 27 and IAS 28 as IAS 27 (2011) Separate Financial Statements and IAS 28 (2011) Investments in associates and joint ventures. The new requirements are effective for annual periods beginning on or after 1 January 2013, with earlier application permitted.	• Judgemental approach • Single control model applies to all investees • Identification of investee activities explicitly required • De facto control included in the model • Exposure or right to variability in returns replaces concept of benefits
IFRS 11 Joint Arrangements	On 12 May 2011, IASB has completed its improvements to the accounting requirements for consolidation, joint arrangements and off balance sheet activities by issuing IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interest in Other Entities. The IASB also amended and renamed IAS 27 and IAS 28 as IAS 27 (2011) Separate Financial Statements and IAS 28 (2011) Investments in associates and joint ventures. The new requirements are effective for annual periods beginning on or after 1 January 2013, with earlier application permitted.	• The structure of the joint arrangement is no longer the main factor in determining the accounting • A single method of accounting for joint ventures
IFRS 12 Disclosure of Interest in Other Entities	On 12 May 2011, IASB has completed its improvements to the accounting requirements for consolidation, joint arrangements and off balance sheet activities by issuing IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosure of Interest in Other Entities. The IASB also amended and renamed IAS 27 and IAS 28 as IAS 27 (2011) Separate Financial Statements and IAS 28 (2011) Investments in associates and joint ventures. The new requirements are effective for annual periods beginning on or after 1 January 2013, with earlier application permitted.	• Additional disclosures required: Expanded disclosures about subsidiaries, joint arrangements and associates. New disclosures about unconsolidated structured entities
IFRS 9 Financial Instruments	On 12 November 2009, the IASB issued IFRS 9 Financial Instruments as the first step in its project to replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 introduces new requirements for classifying and measuring financial assets. On 28 October 2010, the IASB reissued IFRS 9, incorporating new requirements on accounting for financial liabilities, and carrying over from IAS 39 the requirements for derecognition of financial assets and financial liabilities (the Basis for Conclusions was also restructured, and IFRIC 9 and the 2009 version of IFRS 9 were withdrawn). The initial standard and the improvements have an effective date of 1 January 2013. On 4 August 2011, IASB published an exposure draft proposing to push back the mandatory effective date of IFRS 9 Financial Instruments from 1 January 2013 to 1 January 2015.	• Recognition and measurement • Impairment • No more embedded derivatives in financial assets • New measurement category- fair value through other comprehensive income • No more unquoted equity investments measured at cost less impairment • Accounting mismatch • Credit risk

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ED 9 General Hedge accounting	On December 2010, IASB has published ED/2010/13 Hedge accounting. This is the first instalment of the final phase to replace the existing standard on financial instruments, IAS 39 Financial Instruments: Recognition and Measurement. The exposure draft proposes significant changes of the current general hedge accounting requirements. The comment period on the ED closed on 9 March 2011. The IASB began redeliberations on the proposals in the ED in April 2011 and in August 2011 issued some tentative decisions after redeliberation taking into consideration feedback received from the comment letters and outreach activities	• Hedge accounting would be more aligned with risk management • Eligible hedged items would include certain risk components of non-financial items and certain group • Fair value hedge mechanics would be adjusted to align closer with current cash flow hedge mechanics • Hedges would be rebalanced instead of restated; however, voluntary discontinuing would be prohibited • Time value component of purchased options would be accounted for in other comprehensive income
• ED Leases	On 17 August 2011, the IASB and the FASB with ED/2010/9 Leases have published a proposed new standard on accounting by lessees and lessors. The new standard would replace IAS 17 Leases, IFRIC 4 Determining whether an Arrangement contains a Lease, SIC-15 Operating Leases-Incentives and SIC-27 Evaluating the Substance of Transaction involving the Legal Form of a Lease. The IASB plans to hold round-table meetings, and to issue the new standard by June 2011. A second exposure draft is expected in the fourth quarter of 2011.	• Lessees • Single model for lessee accounting, replacing current distinction between operating and finance leases • New measurement basis for lease liability • Recognition and measurement of right-of-use asset • Lessors • Two approaches to lessor accounting, replacing the current distinction between operating and finance leases • New measurement basis for lease asset
ED Revenue Recognition	On 24 June 2010, The IASB published the ED/2010/6 Revenue from Contracts with Customers, in order to introduce an improved and converged global standard on revenue recognition. The IASB tentatively decided at the joint July board meeting to grant four transition reliefs on retrospective application of the new revenue standard. At this meeting the Board tentatively decided to add an exemption to IFRS 1 First-time Adoption of International Financial Reporting Standards to permit a first-time adopter to apply any one of three reliefs. The IASB and FASB plan to publish a second exposure draft of their joint revenue proposals in the third quarter of 2011	• Identification of contracts and performance obligations • Determining transaction prices • Transaction price allocated based on relative stand-alone prices • Withdrawal of percentage of completion method • Accounting for contract costs • Onerous performance obligations
ED Insurance	On 30 July 2010, the IASB published the exposure draft ED/2010/8 Insurance Contracts, proposing a new standard on accounting for insurance contracts, which would replace IFRS 4 Insurance contracts. The proposals represent the first comprehensive IFRS accounting model for insurance contracts. The IASB will continue their discussion on this project at their meeting on 19 to 23 September 2011	• Measurement of insurance contracts • Presentation model for reporting income and expenses arising from insurance contracts based on margins • Acquisition costs • Profit recognition • Disclosure requirements for insurers • Recognizing contract assets and liabilities with no residual margin at the date of transition
ED Measurement of Liabilities in IAS 37	On 5 January 2010, the IASB published an exposure draft of Measurement of Liabilities in IAS 37 – Proposed amendments to IAS 37 (the 2010 ED). The 2010 ED is a follow-up to the Board's 2005 exposure draft of Proposed Amendments to IAS 37 Provisions, Contingent Liabilities and Contingent Assets and IAS 19 Employee Benefits. The 2010 ED is a limited re-exposure addressing certain aspects of proposed measurement guidance for liabilities currently in the scope of IAS 37 Provisions, Contingent Liabilities and Contingent Assets. The replacement standard currently is scheduled to be published in the fourth quarter of 2010	• Establishing a high-level measurement objective for liabilities • Measuring obligations involving services by reference to the price that a contractor would charge to undertake the service • Excluding from the proposed measurement requirements onerous sales and insurance contracts within the scope of IAS 18 Revenue and IFRS 4 Insurance Contracts

Don't forget to ask for your IFRS Illustrative Financial Statements from your KPMG contact person.

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