AIFRS Conference Call

16 August 2005

Commonwealth Bank

Disclaimer

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AIFRS Topics

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- Topic (iii) Consolidation of Special Purpose Vehicles
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Topic (i) – Defined Benefit Pension Plans

- AIFRS Requirement
  - Recognition on balance sheet of surpluses and deficits on defined benefit pension plans.
- Bank's Position
  - Bank has two defined benefit pension plans: an Australian plan with a large surplus and a UK plan with a small deficit.
- Accounting Impact
  - As at 30 June 2004, accounting surplus on Australian plan was $443 million after tax ($633 million before tax) and deficit on UK plan was $54 million after tax ($77 million before tax). Actuarial surplus – which determines future funding requirement – was $1.4 billion before tax.
  - Estimated non-cash pension expense to be recognised in the income statement of approximately $52 million per annum after tax ($75 million before tax) reflecting the accrual accounting charge associated with the expected winding down of the surplus.
  - Actuarial movements of $110 million after tax ($157 million before tax) recognised directly against Retained Earnings in AIFRS FY 2005.
- Indicative Regulatory Impact
  - Current APRA proposal is a Tier 1 capital deduction in respect of deficit, and no recognition of surplus. Impact is to reduce Tier 1 by 3 bpts.

Topic (i) – Defined Benefit Pension Plans

Movement to 30 June 2005:

	Aus Plan $m	UK Plan $m	**Total $m**	Notes
1 July 2004 Surplus/(deficit) on transition	443	(54)	**389**	
Accounting expense (to Profit & Loss)	(49)	(3)	**(52)**	1
Actuarial Gains and other items (to Retained Earnings)	108	2	**110**	2
30 June 2005 Surplus/(deficit)	502	(55)	**447**	

Notes:

1. "Non-cash" accounting charge to reflect winding down of surplus assuming no actuarial movements.
2. Actuarial gains adjusted to Retained Earnings. Mainly due to strong investment markets. Also includes small funding element to UK and foreign exchange differences.

Topic (ii) - Employee Share Schemes

- AIFRS Requirement
  - Employee share scheme trusts are consolidated under AIFRS with any investments in own shares accounted for as ‘Treasury Shares’ and deducted from Share Capital.

- Bank’s Position
  - Bank consolidates the employee share scheme trust and accounts for Treasury Shares.
  - After 30 June 2005, the only deferred share based compensation is the Long Term Incentive Scheme.

- Accounting Impact
  - Period from 1 July 2004 to 30 June 2005:
    - As at 1 July 2004, recognise $126 million of Treasury Shares at cost as a deduction from Share Capital.
    - One-off expense of $32 million occurs in AIFRS FY 2005 (due to discontinuance of mandatory component of Equity Participation Plan).
  - From 1 July 2005:
    - ESAP and Equity Reward Plan Long Term Incentive Scheme (‘LTI’) are the only share based payment schemes remaining.
    - ESAP expensed as paid – therefore no change under AIFRS.
    - LTI - no material difference in P&L impact expected for future periods.

- Indicative Regulatory Impact
  - In discussion with APRA to reverse the reduction in Shareholders’ Equity for regulatory purposes.

Topic (iii) – Consolidation of Special Purpose Vehicles

- AIFRS Requirement
  - Consolidation based on a new 'variability of return' test, as opposed to the existing 'control' test.

- Bank's Position
  - Consolidation of certain special purpose vehicles that are not currently consolidated, e.g. Medallion securitisation vehicles.
  - This is principally due to the greatest variability of return residing with the Bank, as changes in our residual income stream from Medallion exceed the variability of risk borne by investors (eg the credit risk on the mortgages).

- Accounting Impact
  - This results in a gross up of assets and liabilities on the Bank's balance sheet of approximately $8.8 billion as at 1 July 2004.
  - Net increase in assets and liabilities of $3.4 billion for the AIFRS FY 2005.
  - There is no net profit impact arising from consolidation of these vehicles.

- Indicative Regulatory Impact
  - No impact expected.

Topic (iv) – Life Insurance and Funds Management: EMVONA / Appraisal Value Accounting

- AIFRS Requirement
  - Cessation of appraisal value accounting.
- Bank's Position
  - Asset representing the excess of net market value over net assets ('EMVONA') of $6,660m can no longer be recognised in full.
- Accounting Impact

Carrying amount of life insurance entities	9,173	
Net assets – no change	2,513	
AV excess (analysed below)	6,660	
Acquired AV excess	2,759	→ to Goodwill
1 July 2004 self-generated AV excess	2,836	→ w/o against General Reserve
Historic write downs in acquired excess (Asian business)	287	→ w/o against Retained Earnings
FY 2005 AV uplift	778	→ reverse from FY 2005 Profit

  - Carrying value reduces from $9,173m to $5,272m (NTA of $2,513m and Goodwill of $2,759m).
  - RoE (cash basis, at 30 June 2005) increases 2.8% to 18.8% due to this change alone.
- Indicative Regulatory Impact
  - Tier 1 Capital includes value of acquired in-force of $1,152 million, which forms part of the acquired AV excess reclassified to Goodwill. Based on APRA draft announcement, would result in Tier 1 reducing by 61 bpts.

Topic (iv) – Life Insurance and Funds Management: Treasury Shares

- AIFRS Requirement
  - Recognition of all 'Treasury Shares' as a deduction from Share Capital.
- Bank's Position
  - Direct investments in CBA shares by the Bank's life insurance statutory funds currently recognised on balance sheet at net market value.
  - Will be reclassified as 'Treasury Shares' and accounted for at historical cost as deduction against Share Capital.
- Accounting Impact
  - On 1 July 2004:
    - market value of shares removed from assets ($291m) and deducted from Share Capital at cost ($245 million). Cumulative unrealised gains of $46 million reversed (reduction in retained earnings).
  - From 1 July 2004:
    - For FY 2005, all gains reversed from P&L ($39 million)
    - Going forward all movements reversed through P&L (value unknown)
- Issue:
  - Life insurance policyholder liabilities will continue to include the fair value of policyholders' interest in these Treasury Shares.
  - Therefore reversal of movements in Treasury Share investment assets results in a "mismatch" at consolidated group level.
  - The size of the mismatch will vary depending upon movements in the value of CBA shares.

Topic (iv) – Life Insurance and Funds Management: Treasury Shares

- Indicative Regulatory Impact
  - In discussion with APRA to reverse the reduction in Shareholders’ Equity for regulatory purposes.

Topic (iv) - Life Insurance & Funds Management: Initial Entry Fee Income

- AIFRS Requirement
  - Recognise fee income as revenue when the ‘service’ is provided.
- Bank’s Position
  - Charge up-front initial entry fee income on investment-style products where the Bank provides the financial advice.
  - Bank’s AIFRS approach is to continue to recognise this income immediately, as this is when the financial advisory service occurs.
- Issue:
  - Continued uncertainty around worldwide interpretation of AIFRS income recognition rules where an entity provides the financial advice to the customer.
  - Alternative approach is to defer the up-front fee income over the expected life of the underlying investment product.

Topic (iv) - Life Insurance & Funds Management: Initial Entry Fee Income

- Accounting Impact
  - Assuming this income were deferred over the life of the product, the following impacts would arise:

	Group $m	Notes
Non-Life		
1 July 2004 Deferral of up-front fee income - Retained Earnings	**(69)**	1
IFRS FY05 P&L impact	**(9)**	
Life		
1 July 2005 Deferral of up-front fee income - Retained Earnings	**(17)**	2

Notes:

1. Arises on investment-style products (eg FirstChoice and other retail investment trust business) of CFS sold through the Bank's branch network. Due to deferral of income while recognising internal expense up-front. World-wide interpretation still to be finalised on this issue. Currently discussing with international accounting firms and industry peers.
2. Application date is one year later for CCP sales of old retail investment products (eg MasterTrust), as this is a life insurance entity.

Topic (v) - Goodwill

- AIFRS Requirement
  - Goodwill is no longer subject to annual amortisation charge.
  - Goodwill is subject to an impairment test to justify carrying value.
  - Specifically identifiable intangible assets (eg customer lists) continue to be amortised over their useful lives.
- Bank's Position
  - $7,434 million of unamortised Goodwill as at 1 July 2004 (being $4,705 million under Australian GAAP plus $2,729 million reclassification from Appraisal Value excess).
  - Going forward this balance will remain, with impairment testing applied each period.
- Accounting Impact
  - Reverse all FY2005 Goodwill amortisation of $325 million.
  - Add back $4m intangible amortisation.
  - Intangible relates to acquisition of customer lists of TD Waterhouse and AOT (amortise circa $40 million over 10 year life).
- Indicative Regulatory Impact
  - No impact.

Topic (vi) - Foreign Currency Translation Reserve

- AIFRS Requirement
  - Change in methodology for determination of FCTR.
  - One-off transition option to reverse existing FCTR balance at 1 July 2004.
- Bank's Position
  - Adopted transition option to reverse all 1 July 2004 FCTR to Retained Earnings.
  - Alternative would be to take surpluses/deficits as an addition/deduction to future profits on disposal of offshore entities.
- Accounting Impact
  - $205 million deficit in FCTR as at 1 July 2004, transferred to Retained Earnings.
- Indicative Regulatory Impact
  - No impact.

Topic (vii) - Accounting for Income Tax

- AIFRS Requirement
  - Balance sheet approach to tax-effect accounting introduced by IFRS results in the recognition of deferred tax assets and liabilities when there is a difference between carrying value of an asset or liability and its tax base.
- Bank's Position
  - Will involve the recognition of additional tax assets and liabilities in the balance sheet related to the other AIFRS adjustments.
- Accounting Impact
  - No material impact expected on net assets or income statement.

Topic (viii) – Derivative Financial Instruments

- AIFRS Requirement
  - All derivative financial instruments, including embedded derivatives and those used for balance sheet hedging purposes, are to be recognised on-balance sheet and measured at fair value.
  - Hedge accounting can be applied to mitigate the profit and loss volatility that would otherwise arise from recognition of balance sheet hedging derivatives.
  - The two main types of hedges available under the standard are cash flow hedges (where the cash flows associated with an underlying item are being hedged) and fair value hedges (where fair value movements of an underlying item are being hedged).

- Bank's Position
  - The Bank has formulated a hedge accounting strategy based on the use of both cash flow and fair value hedges. The Bank will be predominantly using cash flow hedges because of the practical difficulties of complying with fair value hedging rules.
  - Embedded derivatives from the Bank's portfolio of structured transactions and other options are separated from their underlying contract and fair valued.

Topic (viii) – Derivative Financial Instruments

- Accounting Impact
  - Initial impact on Retained Earnings is a decrease of $313 million. This is comprised of:
    - Initial recognition of cumulative ineffectiveness on all cash flow and fair value hedges;
    - One-off transition adjustment in respect of the novation to external counterparties of the Bank's hedge book; and
    - Initial recognition of non-hedged derivatives and embedded derivatives at fair value.
  - Cash Flow Hedge Reserve of $40 million created at 1 July 2005.
  - It is expected that the new rules around accounting for derivative financial instruments will result in significant volatility from cash flow hedges within equity reserves, and the potential for some volatility within the income statement due to hedge ineffectiveness and fair value movements in other derivatives.

- Indicative Regulatory Impact
  - APRA draft paper proposes to exclude the cash flow hedge reserve from the calculation of regulatory capital.

Topic (ix) – Loan Impairment Provisioning

- AIFRS Requirement
  - Provisioning under AIFRS is on an 'incurred loss' basis. Objective evidence that an impairment event has occurred is required before a provision can be recognised.

- Bank's Position
  - The Bank's current general provision for loan impairment covers losses known to be inherent in the portfolio. This is calculated on probable losses estimated from origination over the entire life of the loan.

- Accounting Impact
  - Due to the evolving nature of industry AIFRS interpretation, the Bank, and our industry peers are not in a position to finalise provisioning levels. The Bank is continuing to discuss these issues with our industry peers and international accounting firms to seek a satisfactory resolution.
  - Differing overseas methodologies and interpretations are emerging.

Topic (ix) – Loan Impairment Provisioning

- Indicative Regulatory Impact
  - APRA proposing creation of General Reserve for Credit Losses (Tier 2 capital) equal to at least 0.5% of risk weighted assets.
  - Uncertainty as to APRA interpretation of AIFRS provisioning.

- Summary

Existing GAAP	AIFRS	Regulatory Capital
Specific Provision	Individually Assessed	Individually Assessed
General Provision under Dynamic Provisioning	Collective/Incurred + Judgmental	Treatment of Collective/ Incurred Losses
		General Reserve for Credit Losses

Topic (x) – Hybrid Financial Instruments

- AIFRS Requirement
  - Hybrid financial instruments must be reclassified from equity to liabilities on transition to AIFRS if there is *any* possibility of conversion to variable number of ordinary shares.
- Bank's Position
  - Hybrids are currently classified as equity and are included within Tier 1 regulatory capital. Distributions are disclosed "below the line" as appropriation of profit.
  - The Bank has five hybrid financial instruments:
    - PERLS, PERLS II and Trust Preferred Securities will be reclassified
    - ASB Capital and ASB Capital No.2 Preference Shares will not be reclassified
- Accounting Impact
  - On transition distributions on the hybrids reclassified as liabilities will be treated as interest expense ($115m per annum).
  - Distributions are already allowed for within Cash EPS calculations.
- Indicative Regulatory Impact
  - Awaiting formal guidance on regulatory capital treatment. APRA have previously indicated that Tier 1 instruments approved before 31 March 2004 will be eligible for any grandfathering/transitional arrangements that APRA may put in place.

Topic (x) - Hybrid Financial Instruments

Journal entry is:	Dr $m	Cr $m	Note
Dr. Hybrid Equity Instruments	**2,260**		1
Cr. Hybrid Liability Instruments		**2159**	2
Cr. Retained Earnings		**22**	3
Cr. FCTR		**79**	4
	2,260	**2,260**	

- One type of hybrid instrument - the Trust Preferred Securities (TPS) - is denominated in USD.
- Exchange rate movements in the assets associated with the TPS structure have historically been accounted for within FCTR, while the hybrid was not.
- On reclassification of the hybrids from equity to debt they are retranslated at current rather than original rate, resulting in an impact to FCTR to account for the exchange rate movements for AIFRS from 1 July 2004 ($79million - FCTR) and for the period prior to 1July 2004 ($22 million - Retained earnings - due to transfer of FCTR to RE under AIFRS at 1 July 2004).

Notes

1. Hybrid translated at original exchange rate
2. Hybrid translated at current exchange rate
3. Mainly pre-1 July 2004 exchange rate movements transferred to R/E
4. FY 2005 exchange rate movement USD to AUD

Topic (xi) - Revenue and Expense Recognition: Banking

- AIFRS Requirement
  - Fee income integral to the yield of an originated financial instrument must be capitalised and amortised into Net Interest Income over the expected life of the instrument, net of any direct and incremental costs.

- Bank's Position
  - Will involve capitalising and amortising fee income such as establishment fees on retail mortgage products and corporate loans; and expenses such as third party broker commissions on mortgage products. These income and expense items are currently recognised in full on origination.
  - Currently, corporate loan portfolio generates net income on origination; and retail portfolio net expense on origination.
- Accounting Impact
  - Due to the offsetting nature of income and expense items across the Bank, this change is not expected to materially affect net profit.
  - Opening adjustment to decrease Retained Earnings by $61 million after tax (being the net deferral of income across the Bank).
  - However, reclassifications will occur between Other Income and Net Interest Income involving approximately $90 million of income and approximately $90 million of expenses (per annum). No material net impact on NIM.

Topic (xii) – Life Insurance and Funds Management: Income Recognition

- AIFRS Requirement
  - Initial entry fee income earned on retail investment products where third parties provide financial advice must be capitalised and amortised over the life of the product.
- Bank's Position
  - For most of our Wealth Management business, up-front fee income equals third party commissions. Therefore net nil impact.
  - For some products however, up-front fee income is slightly higher than the commissions paid. Leads to net deferral of income.
- Accounting Impact
  - Where the initial entry fee income exceeds the initial commission expense, this results in a decrease in Retained Earnings of $75 million after tax.
  - Ongoing impact of this income deferral is not material assuming we maintain sales of these products at a consistent level.

Topic (xii) – Life Insurance & Funds Management: Measurement Differences

- Deferred Acquisition Costs
  - New definition results in investment-style products within Wealth Management no longer being accounted for under insurance accounting rules (i.e. AASB 1038)
  - Will result in lower levels of deferred acquisition cost ('DAC') capitalisation (DAC decrease of $128m). Principally relates to a closed book of business, and will therefore result in positive future P&L versus AGAAP.

- Change in Insurance Policyholder Liabilities calculation
  - AIFRS prescribes use of more conservative discount rate assumptions in valuing insurance contract liabilities.
  - Results in a $120m increase in policyholder liabilities, principally in relation to the Hong Kong life insurance business.

	Group $m
DAC Write Off - to Retained Earnings	(128)
Policyholder Liabilities - to Retained Earnings	(120)
Total	(248)

Topic (xii) - Life Insurance and Funds Management: Outside Equity Interests

- AIFRS Requirement
  - Unitholder funds in consolidated life insurance statutory funds reclassified from equity to other liabilities.
  - Treatment is driven by the ability of unitholders to redeem units at their own discretion.

- Accounting Impact
  - At 1 July 2005, results in a reclassification of $1,158 million of outside equity interests in the units of the Bank's consolidated life insurance statutory funds.

- Indicative Regulatory Impact
  - No impact on regulatory capital (already excluded from Tier 1 capital).

Topic (xiii) – Banking Financial Instruments

- AIFRS Requirement
  - Classification and measurement changes in respect of financial instruments.

- Bank's Position
  - The following table summarises the key categories and resulting valuation bases for the Bank's financial instruments

AIFRS Financial Instrument Categories	Bank Asset Allocation	Current Measurement	AIFRS Measurement
Loans and Receivables	Majority of existing loans and receivables	Cost	Cost
Available-for-Sale	Majority of existing investment securities	Cost	Fair Value through Reserves
Fair Value Option	All trading securities remain at fair value Some structured finance deals move from cost to fair value through profit and loss	Fair Value through Profit & Loss Cost	Fair Value through Profit & Loss
Held-to-maturity	No existing assets allocated to this category due to difficulty in maintaining classification under the AIFRS rules	Cost	Cost

Topic (xiii) – Banking Financial Instruments

- Accounting Impact
  - Available-for-sale Reserve of $68 million recognised at 1 July 2005.
  - Retained Earnings decrease of $3 million at 1 July 2005 in respect of fair value through profit and loss items.
  - Some future P&L volatility created by moving investment securities and some structured finance deals into a fair value environment. Not expected to be material to P&L based on historical analysis of fair value disclosures.

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