

## Note 2 - Accounting principles

### **Basis for preparing the consolidated annual accounts**

The Group accounts for 2015 for SpareBank 1 SMN have been prepared in conformity with International Financial Reporting Standards (IFRS) which have been given effect in Norway. These include interpretations from the International Financial Reporting Interpretations Committee (IFRIC) and its predecessor, the Standing Interpretations Committee (SIC). The measurement base for both the parent bank and group accounts is historical cost with the modifications described below. The accounts are presented based on IFRS standards and interpretations mandatory for accounts presented as at 31 December 2015.

### **Implemented accounting standards and other relevant rule changes in 2015**

#### *IFRIC 21 Levies*

IFRIC 21 Levies clarifies that the obligating event that gives rise to a liability to pay a levy is the activity defined in the relevant legislation that triggers the payment of the levy. In addition, IFRIC 21 states that the obligation to pay a levy is recognised progressively if the obligating event occurs over time (i.e. if the activity that triggers payment of the levy in accordance with the legislation occurs over time). If an obligation to pay a levy is triggered on reaching a minimum threshold, the liability is recognised when this minimum threshold is reached. IFRIC 21 shall be implemented retrospectively.

For SpareBank1 SMN the interpretation has changed the accounting treatment for wealth tax. Wealth tax is calculated on the bank's assets at year-end and is therefore recognised in December of the accounting year. In previous years this was done monthly on an accruals basis.

#### *Guarantee Fund levy*

The levy to the Banks' Guarantee Fund is normally based on previous quarters' average guaranteed deposits and average risk weighted assets. The question of whether withdrawing from the guarantee fund arrangement will entail a refund of levy paid in excess is not regulated. In practice a pro rata charge has been made upon enrolment. This practice and consistency of treatment suggest a pro rata approach upon withdrawal. The Ministry of Finance will settle the matter by administrative decision. This has a bearing on when the levy is to be recognised in the accounts. In 2015 SpareBank 1 SMN has continued its earlier practice of accrual on a monthly basis.

SpareBank 1 SMN implemented IFRIC 21 on 1 January 2015.

#### *Annual Improvements 2011-2013 Cycle*

These amendments apply to annual accounts that started on 1 January 2015 or later. The Group has applied the amendments for the first time in the financial statements for 2015. The amendments cover:

#### *IFRS 3 Business Combinations*

The amendment is applied prospectively and clarifies the exceptions from the scope of IFRS 3:

- The formation of joint arrangements, not only joint ventures, is outside the scope of IFRS 3
- This scope exception applies only to the accounting in the financial statements of the joint arrangement itself

#### *IFRS 13 Fair Value Measurement*

The amendment is implemented prospectively and clarifies that the portfolio exception in IFRS 13 can not only be applied to financial assets and financial liabilities, but also to other contracts which fall under the scope of IAS 39.

#### *IAS 40 Investment Property*

The description of ancillary services in IAS 40 differentiates between investment property and owner-occupied property (within the scope of IAS 16). The amendment, which shall be applied prospectively, clarifies that IFRS 3, and not the description of ancillary services in IAS 40, shall be used in order to determine whether a transaction constitutes a business combination or the purchase of individual assets.

### **New or revised accounting standards approved but not implemented in 2015**

#### *IFRS 9 Financial Instruments*

IASB published the final version of IFRS 9 Financial Instruments in July 2014. IFRS 9 will replace IAS 39 Financial Instrument: Recognition and Measurement. IFRS 9 results in changes to classification and measurement, hedge accounting and impairment. The standard will be applicable for periods starting on or after January 1, 2018. Early adoption is permitted, but the standard has not yet been approved by EU. The standard shall be implemented retrospectively, with the exception of hedge accounting, but it is not a requirement to prepare comparative figures. The rules for hedge accounting shall mainly be implemented prospectively, with certain few exceptions.

The Group has no plans regarding early implementation of the standard, and will implement IFRS from January 1, 2018. In 2015 the Group have performed an overall assessment of the implementation effects. The preliminary assessment is based on the information available at the time, and may change as more detailed analyses or more information is made available in the future. The Group does not

expect significant effects on the financial position or equity as a consequence of the implementation, except the effect of applying the standard for impairment on loans. New principles for impairment will possibly give increased losses, which will impact equity negatively. The bank will in 2016 perform a detailed assessment to be able to determine the accrual for losses more exact.

*IFRS 15 Revenue from Contracts with Customers* is a new converged standard for revenue recognition which replaces all existing standards and interpretations relating to revenue recognition. The standard is applicable for all remunerative contracts and includes a model for recognition and measurement of sale of individual non-financial assets. The Group does not expect IFRS 15 to have a significant impact on its principles for revenue recognition. Expected implementation is January 1, 2017 at the earliest.

#### *IFRS 16 Leases*

In January 2016, the IASB issued IFRS 16 'Leases' with an effective date of annual periods beginning on or after 1 January 2019. IFRS 16 results in lessees accounting for most leases within the scope of the standard in a manner similar to the way in which finance leases are currently accounted for under IAS 17 'Leases'. Lessees will recognise a 'right of use' asset and a corresponding financial liability on the statement of financial position. The asset will be amortised over the length of the lease and the financial liability measured at amortised cost. Lessor accounting remains substantially the same as in IAS 17. SpareBank 1 SMN is currently assessing the impact of IFRS 16 and it is not practicable to quantify the effect as at the date of the publication of these financial statements.

#### **Presentation currency**

The presentation currency is the Norwegian krone (NOK), which is also the Bank's functional currency. All amounts are stated in millions of NOK unless otherwise specified.

#### **Consolidation**

The Group accounts include the Bank and all subsidiaries which are not due for divestment in the near future and which are therefore to be classified as held for sale under IFRS 5. All undertakings controlled by the Bank, i.e. where the Bank has the power to control the undertaking's financial and operational principles with the intention of achieving benefits from the undertaking's activities, are regarded as subsidiaries. Subsidiaries are consolidated from the date on which the Bank has taken over control, and are deconsolidated at the date on which the Bank relinquishes control. Mutual balance sheet items and all significant profit elements are eliminated.

Upon takeover of control of an enterprise (business combination), all identifiable assets and liabilities are recognised at fair value in accordance with IFRS 3. A positive difference between fair value of the consideration and the fair value of identifiable assets and liabilities is recorded as goodwill, while a negative difference is taken to income upon purchase. Accounting for goodwill after first-time recognition is described under the section on intangible assets.

All intra-group transactions are eliminated in the preparation of the Group accounts. The non-controlling interests' share of the Group result is presented on a separate line under profit after tax in the income statement. In the statement of changes in equity, the non-controlling interests' share is shown as a separate item.

#### **Associated companies**

Associated companies are companies in which the Bank has substantial influence. As a rule, influence is substantial where the Bank has an ownership interest of 20 percent or more. Associated companies are accounted for by the equity method in the Group accounts. The investment is initially recognised at acquisition cost and subsequently adjusted for change in the Bank's share of the associated undertaking's net assets. The Bank recognises its share of the profit of the associated undertaking in its income statement. Associated companies are accounted for in the Parent bank accounts by the cost method. See also note 39 Investments in owner interest.

#### **Joint ventures**

Joint ventures may take the form of jointly controlled operations, jointly controlled assets or jointly controlled entities. Joint control entails that the Bank by agreement exercises control together with other participants. The Bank accounts for jointly controlled operations and jointly controlled assets by recognising the Bank's proportional share of assets and liabilities in the Bank's accounts. The governance structure for SpareBank 1 collaboration is regulated by an agreement between the owners. The Group classifies its participation in some companies as investments in jointly controlled entities and accounts for them by the equity method. See also note 39 Investments in owner interest.

#### **Loans and loan losses**

Loans are measured at amortised cost in accordance with IAS 39. Amortised cost is acquisition cost less repayments of principle, plus or minus cumulative amortisation resulting from the effective interest rate method, with deductions for any value fall or loss likelihood. The effective interest rate is the interest rate which precisely discounts estimated future cash in- or out-payments over the financial instrument's expected lifetime.

Fixed interest loans to customers are recognised at fair value. Gains and losses due to changes in fair value are recognised in the income statement as fair value changes. Accrued interest and premiums/discounts are recognised as interest. Interest rate risk on fixed interest

loans is managed through interest rate swaps which are recognised at fair value. It is the Group's view that recognising fixed interest loans at fair value provides more relevant information on carrying values.

#### **Write-down**

Amounts recorded on the Bank's statement of financial position are reviewed on the balance sheet date for any indications of value impairment. Should such indications be present, an estimate is made of the asset's recoverable amount. Each year on the balance sheet date recoverable amounts on goodwill, assets with unlimited useful lifetime, and intangible assets not yet available for use, are computed. Write-down is undertaken when the recorded value of an asset or cash-flow-generating entity exceeds the recoverable amount. Write-downs are recognised in profit/loss. Write-down of goodwill is not reversed. In the case of other assets, write-downs are reversed where there is a change in estimates used to compute the recoverable amount.

#### **Individual write-downs on financial assets**

Value impairment on loans is incurred if, and only if, there exists objective evidence of a value impairment which may entail reduced future cash flow to service the exposure. Value impairment must be a result of one or more events occurring after first-time recognition (a loss event), and it must be possible to measure the result of the loss event(s) reliably. Objective evidence of value impairment of a financial asset includes observable data which come to the Group's knowledge on the following loss events:

- significant financial difficulties on the part of the issuer or borrower
- not insignificant breach of contract, such as failure to pay instalments and interest
- the Group grants the borrower special terms in light of financial or legal aspects of the borrower's situation
- the debtor is likely to start debt negotiation or other financial restructuring
- active markets for the financial asset are closed due to financial problems.

The Group assesses first whether individual objective evidence exists that individually significant financial assets have suffered value impairment.

Where there is objective evidence of value impairment, the size of the impairment is measured as the difference between the asset's carrying value and the present value of estimated future cash flows (excluding future credit losses that have not been incurred), discounted at the financial asset's original effective interest rate. The carrying value of the asset is reduced through a provision account and the loss is recognised in the income statement.

Assets that are individually tested for value impairment, and where value impairment is identified, or is still being identified, are not included in an overall assessment of value impairment.

#### **Collective write-downs on loans**

In the case of financial assets which are not individually significant, the objective evidence of value impairment is assessed on an individual or collective basis. Should the Group decide that no objective evidence exists of value impairment of an individually assessed financial asset, significant or not, that asset is included in a group of financial assets sharing the same credit risk characteristics such as observable data indicating a measurable reduction in future cash flows from a group of financial assets since first-time recognition, even if the reduction cannot yet be fully identified to an individual financial asset in the Group including:

- an unfavourable development in payment status for borrowers in the Group
- national or local economic conditions correlating with defaults of assets in the Group

Value impairment of groups of financial assets is measured by the trend in rating for such groups. This is done by measuring negative migration and change in expected loss.

Determining customer migration involves continuous assessment of the creditworthiness of every single customer in the Bank's credit assessment systems.

In the case of events that have occurred but have yet to be reflected in the Bank's portfolio monitoring systems, the need for impairment write-downs is estimated group-wise using stress test models.

#### **Non-performing/potential problem loans**

The overall exposure to a customer is regarded as non-performing and is included in the Group's lists of non-performing exposures once instalment and interest payments are 90 days or more past due or credit lines are overdrawn by 90 days or more. Loans and other exposures which are not non-performing but where the customer's financial situation makes it likely that the Group will incur loss are classified as potential problem loans.

**Value impairment of loans recognised at fair value**

At each balance sheet date the Group assesses whether evidence exists that a financial asset or group of financial assets recognised at fair value is susceptible to value impairment. Losses due to value impairment are recognised in the income statement in the period in which they arise.

**Actual losses**

Where the balance of evidence suggests that losses are permanent, losses are classified as actual losses. Actual losses covered by earlier specified loss provisions are reflected in such loss provisions. Actual losses not covered by loss provisions, as well as surpluses and deficits in relation to earlier loss provisions, are recognised in the income statement.

**Repossessed assets**

As part of its treatment of defaulted loans and guarantees, the Bank in a number of cases takes over assets furnished as security for such exposures. Upon repossession the assets are valued at their presumed realisable value. Any deviation from the carrying value of a defaulted or written down exposure upon takeover is classified as a loan write-down. Repossessed assets are carried according to type. Upon final disposal, the deviation from carrying value is entered in profit or loss based on the asset's type in the accounts.

**Non-current assets held for sale and discontinued operations**

Assets which the Board of Directors of the Bank has decided to sell are dealt with under IFRS 5. This type of asset is for the most part assets taken over in connection with bad loans, and investments in subsidiaries held for sale. In the case of assets which are initially depreciated, depreciation ceases when a decision is taken to sell. The result of such activity and appurtenant assets and liabilities are presented on a separate line as held for sale.

**Leases**

Financial leases are entered under the main item "loans" in the balance sheet and accounted for at amortised cost. All fixed revenues within the lease's expected lifetime are included when computing the effective interest.

**Securities and derivatives**

Securities and derivatives comprise shares and units, money market instruments and bonds, and derivative equity, currency and interest-rate instruments. Shares and units are classified either at fair value through profit/loss or as available for sale. Money market instruments and bonds are classified at fair value through profit/loss, loans and receivables or in the category held to maturity. Derivatives are invariably recognised at fair value through profit/loss unless they are part of a cash flow hedge. However the Bank does not avail itself of cash flow hedges.

All financial instruments classified at fair value through profit/loss are measured at fair value, and change in value from the opening balance is recognised as revenue from other financial investments. Financial assets held for trading purposes are characterised by frequent trading and by positions being taken with the aim of short-term gain. Other such financial assets classified at fair value through profit/loss are investments defined upon initial recognition as classified at fair value through profit/loss (fair value option).

Derivatives are presented as assets when fair value is positive, and as liabilities when fair value is negative.

Shares and units classified as available for sale are also measured at fair value, but the change in value from the opening balance is recognised in the comprehensive income statement and is accordingly included in other comprehensive income. Shares which cannot be reliably measured are valued at cost price under IAS 39.46 c). Routines for ongoing valuation of all share investments have been established. These valuations are carried out at differing intervals in relation to the size of the investment.

Money market instruments and bonds classified as loans and receivables or held to maturity are measured at amortised cost using the effective interest rate method; see the account of this method under the section on loans.

**Intangible assets**

Intangible assets mainly comprise goodwill in the Group. Other intangible assets will be recognised once the conditions for entry in the balance sheet are present. Goodwill arises as the difference between the fair value of the consideration upon purchase of a business and the fair value of identifiable assets and liabilities; see description under Consolidation. Goodwill is not amortised, but is subject to an annual depreciation test with a view to revealing any impairment, in keeping with IAS 36. Testing for value impairment is done at the lowest level at which cash flows can be identified.

**Property, plant and equipment**

Property, plant and equipment along with property used by the owner are accounted for in accordance with IAS 16. The investment is initially measured at its cost and is thereafter depreciated on a linear basis over its expected useful life. When establishing a depreciation

plan, the individual assets are to the necessary extent split up into components with differing useful life, with account being taken of estimated residual value. Property, plant and equipment items which individually are of little significance, for example PCs, and other office equipment, are not individually assessed for residual value, useful lifetime or value loss, but are assessed as groups. Property used by the owner's, according to the definition in IAS 40, property that is mainly used by the Bank or its subsidiary for its own use.

Property, plant and equipment which are depreciated are subject to a depreciation test in accordance with IAS 36 when circumstances so indicate.

Property held in order to earn rentals or for capital appreciation is classified as investment property and is measured at fair value in accordance with IAS 40. The Group has no investment properties.

### **Interest income and expenses**

Interest income and expenses related to assets and liabilities which are measured at amortised cost are recognised in profit/loss on an ongoing basis using the effective interest rate method. Charges connected to interest-bearing funding and lending are included in the computation of effective interest rate and are amortised over expected lifetime. In the case of interest-bearing instruments measured at fair value, the market value will be classified as income from other financial investments. In the case of interest-bearing instruments classified as loans and receivables or held to maturity and not utilised in hedging contexts, the premium/discount is amortised as interest income over the term of the contract.

### **Commission income and expenses**

Commission income and expenses are generally accrued in step with the provision of the service. Charges related to interest-bearing instruments are not entered as commission, but are included in the calculation of effective interest and recognised in profit/loss accordingly. Consultancy fees accrue in accordance with a consultancy agreement, usually in step with the provision of the service. The same applies to ongoing management services. Fees and charges in connection with the sale or mediation of financial instruments, property or other investment objects which do not generate balance sheet items in the Bank's accounts are recognised in profit/loss when the transaction is completed. The Bank receives commission from SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt corresponding to the difference between the interest on the loan and the funding cost achieved by SpareBank 1 Boligkreditt and SpareBank 1 Næringskreditt. This shows as commission income in the Bank's accounts.

### **Transactions and holdings in foreign currency**

Transactions in foreign currency are converted to Norwegian kroner at the transaction exchange rate. Gains and losses on executed transactions or on conversion of holdings of monetary items on the balance sheet date are recognised in profit/loss, unless they are recognised directly in equity based on hedging principles. Gains and losses on conversion of items other than monetary items are recognised in the same way as the appurtenant balance sheet item.

### **Hedge accounting**

The Bank evaluates and documents the effectiveness of a hedge when first entered in the balance sheet. The Bank employs fair value hedging to manage its interest rate risk. In its hedging operations the Bank protects against movements in the market interest rate. Changes in credit spread are not taken to account in respect of hedge effectiveness. In the case of fair value hedging, both the hedging instrument and the hedged object are recorded at fair value, and changes in these values from the opening balance are recognised in profit/loss.

### **Fair value option**

The Bank's fixed rate loans are recognised at fair value by using the fair value option, in accordance with IAS 39, and the Bank controls interest rate risk attached to these loans through the use of derivatives.

### **Income taxes**

Tax recorded in the profit and loss account comprises tax in the period (payable tax) and deferred tax. Period tax is tax calculated on the taxable profit for the year. Deferred tax is accounted for by the liability method in accordance with IAS 12. In the case of deferred tax, liabilities or assets are calculated on temporary differences i.e. the difference between balance-sheet value and tax-related value of assets and liabilities. However, liabilities or assets are not calculated in the case of deferred tax on goodwill for which there is no deduction for tax purposes, nor on first-time-recognised items which affect neither the accounting nor the taxable profit.

Deferred tax asset is calculated on a tax loss carryforward. Deferred tax assets are recognised only to the extent that there is expectation of future taxable profits that enable use of the tax asset. Withholding tax is presented as period tax. Wealth tax is presented as an operating expense in the Group accounts in conformity with IAS 12.

### **Deposits from customers**

Customer deposits are recognised at amortised cost.

**Debt created by issuance of securities**

Loans not included in hedge accounting are initially recognised at acquisition cost. This is the fair value of the compensation received after deduction of transaction fees. Loans are thereafter measured at amortised cost. Any difference between acquisition cost and settlement amount at maturity is accordingly accrued over the term of loan using the effective rate of interest on the loan. The fair value option is not applied in relation to group debt.

**Subordinated debt and hybrid capital**

Subordinated debt and hybrid capital are classified as liabilities in the statement of financial position and are measured at amortised cost like other long-term loans. Subordinated debt ranks behind all other debt. Hybrid capital denotes bonds with a nominal interest rate, but the Bank is not obliged to pay interest in a period in which no dividend is paid, nor does the investor subsequently have a right to interest that has not been paid, i.e. the interest does not accumulate. The treatment of subordinated debt and hybrid capital in the calculation of the Group's capital adequacy is described in note 5 Capital adequacy and capital management.

**Uncertain commitments**

The Bank issues financial guarantees as part of its ordinary business. Loss assessments are made as part of the assessment of loan losses, are based on the same principles and are reported together with loan losses. Provisions are made for other contingent liabilities where there is a preponderant likelihood that the commitment will materialise and the financial consequences can be reliably measured. Information is disclosed on contingent liabilities which do not meet the criteria for recognition where such commitments are substantial. Restructuring expenses are provisioned in cases where the Bank has a contractual or legal obligation.

**Pensions**

The Group has established various pension schemes for its staff. The pension schemes meet the requirements set for mandatory occupational pensions. The Group applies IAS 19R Employee Benefits, and all actuarial gains and losses are recognised in other comprehensive income. See also note 24 on pensions.

**Defined benefit scheme**

In a defined benefit scheme the employer is obliged to pay a future pension of a specified size. The calculation of pension costs is based on a linear distribution of the pension earned against the probable accumulated liability at retirement. The costs are calculated on the basis of the pension rights accrued over the year less the return on the pension assets. The pension obligation is calculated as the present value of estimated future pension benefits which per the accounts are deemed to have been earned as of the balance sheet date. When calculating the pension liability use is made of actuarial and economic assumptions with regard to longevity, wage growth and the proportion likely to take early retirement. As from 2012, the interest rate on covered bonds is used as the discount rate in accordance with the recommendation of the Norwegian Accounting Standards Board.

Changes in pension plans are recognised at the time of the change. The pension cost is based on assumptions set at the beginning of the period and is presented as a personnel expense in the accounts. Employer's contribution is allocated on pension costs and pension liabilities.

The pension scheme is administered by a pension fund conferring entitlement to specific future pension benefits from age 67. The schemes include children's pension and disability pension under further rules. The Group's defined benefit pension scheme assures the majority of employees a pension of 68 percent of final salary up to 12G. The defined benefit scheme is closed to new members.

**Defined contribution**

Under a defined contribution pension scheme the Group does not provide a future pension of a given size; instead the Group pays an annual contribution the employees' collection pension savings. The Group has no further obligations regarding the labour contribution after the annual contribution has been paid. There is no allocation for accrued pension obligations under such schemes. Defined contribution schemes are directly expensed.

The Group has made a defined contribution pension scheme available to its employees since 1 January 2008.

**Early retirement pension scheme ("AFP")**

The Banking and financial industry has established an agreement on an early retirement pension scheme ("AFP") for employees from age 62. The Bank pays 100 per cent of the pension paid from age 62 to 64 and 60 per cent of the pension paid from age 65 to age 67. Admission of new retirees ceased with effect from 31 December 2010.

The Act relating to state subsidies in respect of employees who take out contractual pension in the private sector (AFP Subsidies Act) entered into force on 19 February 2010. Employees who take out AFP with effect in 2011 or later will receive benefits under the new scheme. The new AFP scheme represents a lifelong add-on to National Insurance and can be taken out from age 62. Employees accumulate AFP entitlement at an annual rate of 0.314 percent of pensionable income capped at 7.1 G up to age 62. Accumulation under

the new scheme is calculated with reference to the employee's lifetime income, such that all previous working years are included in the qualifying basis.

For accounting purposes the new AFP scheme is regarded as a defined benefit multi-employer scheme. This entails that each employer accounts for its pro rata share of the scheme's pension obligation, pension assets and pension cost. If no calculations of the individual components of the scheme and a consistent and reliable basis for allocation are available, the new AFP scheme will be accounted for as a defined-contribution scheme. At the present time no such basis exists, and the new AFP scheme is accordingly accounted for as a defined-contribution scheme. The new AFP scheme will only be accounted for as a defined-benefit scheme once reliable measurement and allocation can be undertaken. Under the new scheme, one-third of the pension expenses will be funded by the State, two-thirds by the employers. The employers' premium will be fixed as a percentage of salary payments between 1G and 7.1 G.

In keeping with the recommendation of the Norwegian Accounting Standards Board, no provision was made for the Group's de facto AFP obligation. This is because the office coordinating the schemes run by the main employer and trade union organisations has so far not performed the necessary calculations.

### **Segment reporting**

SpareBank 1 SMN has Retail Market and Corporate Market, along with the most important subsidiaries and associates as its primary reporting format. The Group presents a sectoral and industry distribution of loans and deposits as its secondary reporting format. The Group's segment reporting is in conformity with IFRS 8.

### **Dividends and gifts**

Dividends on equity capital certificates and gifts are recognised as equity capital in the period to the declaration of dividends by the Bank's Supervisory Board.

### **Events after the balance sheet date**

The annual accounts are regarded as approved for publication once they have been considered by the Board of Directors. The Supervisory Board and regulatory authorities can thereafter refuse to approve the accounts, but not to change them. Events up to the time at which the accounts are approved for publication, and which relate to circumstances already known on the balance sheet date, will be included in the information base for accounting estimates and thus be fully reflected in the accounts. Events concerning circumstances that were not known on the balance sheet date will be illuminated if significant.

The accounts are presented on the going-concern assumption. In the view of the Board of Directors this assumption was met at the time the accounts were approved for presentation.

The Board of Directors' proposal for dividends is set out in the Directors' report and in the statement of changes in equity.