

Note 2 - Accounting principles

Basis for preparing the consolidated annual accounts

The Group accounts for 2017 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 2017.

Implemented accounting standards and other relevant rule changes in 2017

The applied accounting principles are consistent with the principles applied in the preceding accounting period, with the exception of those changes to IFRS which have been implemented by the group in the current accounting period. Below is a list of amendments to IFRS with effect for the 2017 accounts that have been relevant, and the effect they have had on the group's annual accounts.

The following new and amended accounting standards and interpretations were applied for the first time in 2017:

IAS 12 Income taxes - amendment

The amendments clarify how to report assets for deferred tax related to unrealised losses on debt instruments valued at fair value. Specifically, it clarifies that unrealised losses on debt instruments measured at fair value in the accounts, and at cost for tax purposes, result in tax-reducing temporary differences regardless of how the owner expects to recover the capitalised amount. The amendments clarify the accounting treatment for recognition of deferred tax assets to debt instruments that are measured at fair value in certain cases.

The amendments will have effect from 1 January 2017 and has been implemented retrospectively.

IFRS 12 Disclosure of Interests in Other Entities - amendment

The amendments clarify that some of the Notes to the Standard apply to an entity's interests in subsidiaries, joint ventures or associates that are classified as (or included in a disposal group classified as) held for sale.

The amendment has been implemented retrospectively.

IAS 7 Statement of Cash Flows - amendment

IAS 7 has been amended by introducing a disclosure requirement relating to changes in financial liabilities arising from financing activities. The change does not entail any changes in the recognition and measurement of financial liabilities.

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 kroner unless otherwise specified.

Consolidation

The consolidated accounts include the Bank and all subsidiaries which are not due for divestment in the near future and 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 as of 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 the fair value of the consideration and the fair value of identifiable assets and liabilities is recorded as goodwill, while any 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 consolidated accounts. The non-controlling interests' share of the group result is to be 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

Associates are companies in which the Bank has substantial influence. As a rule, influence is substantial where the Bank has an ownership interest of 20 per cent or more. Associates are accounted for by the equity method in the consolidated accounts. The investment is initially recognised at acquisition cost and subsequently adjusted for the 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. Associates are accounted for in the parent bank accounts by the cost method. See also note 39 Investments in owner interests.

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 the SpareBank 1 collaboration is regulated by 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 interests.

Loans and loan losses

Loans are measured at amortised cost in accordance with IAS 39. Amortised cost is acquisition cost less repayments of principal, 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-downs

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-downs are 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 the estimates used to compute the recoverable amount.

Individual write-downs on financial assets

Impairment on loans is incurred if, and only if, there exists objective evidence of impairment which may entail reduced future cash flow to service the exposure. 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 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
- a 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 impairment.

Where there is objective evidence of 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 impairment, and where impairment is identified, or is still being identified, are not included in an overall assessment of 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.

In the assessment of collective write-downs account is taken inter alia of the following:

- 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.

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 over the portfolio's lifetime.

Determining customer migration involves continuous assessment of the creditworthiness of each individual 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 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, prompting an individually assessed write-down, are classified as potential problem loans.

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 impairment. Losses due to impairment are recognised in the income statement in the period in which they arise.

Actual losses

Where the balance of evidence suggests that the losses are permanent, the 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.

Reposessed assets

As part of its treatment of defaulted loans and guarantees, the Bank in a number of cases takes over assets furnished as collateral 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. Reposessed assets are carried according to type. Upon final disposal, the deviation from carrying value is reported in profit or loss in accordance with the type of asset as per 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 if it is highly likely that the asset will be sold within 12 months. This type of asset comprises for the most part assets taken over in connection with bad loans, and investments in subsidiaries held for sale. In the case of depreciable assets, depreciation ceases when a decision is taken to sell, and the asset is measured at fair value in accordance with IFRS 5. 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 contract's effective interest.

Securities and derivatives

Securities and derivatives comprise shares and units, money market instruments and bonds, and derivative currency, fixed income and equity 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 any 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 first-time recognition as classified at fair value through profit/loss (fair value option).

Financial 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 any change in value from the opening balance is recognised in the comprehensive income statement and is accordingly included in the group's other comprehensive income. Shares which cannot be reliably measured are valued at cost price under IAS 39.46 (c). Procedures for ongoing valuation of all equity investments have been established. These valuations are carried out at differing intervals in based on 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 SpareBank 1 SMN 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.

Intangible assets acquired separately are carried at cost. Useful economic life is either finite or infinite. Intangible assets with a finite economic life are depreciated over their economic life and tested for impairment upon any indication of impairment. The depreciation method and period are assessed at least once each year.

Property, plant and equipment

Property, plant and equipment along with property used by the owner are accounted for under IAS 16. The investment is initially recognised at its acquisition 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 computers and other office equipment, are not individually assessed for residual value, useful lifetime or value loss, but are assessed on a group basis. Property used by the owner, according to the definition in IAS 40, is 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. 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 in accordance with IAS 39. 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 when measuring 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 Parent Bank's fixed rate loans are recognised in profit/loss at fair value by using the fair value option, in accordance with IAS 39, and the Bank manages interest rate risk related to these loans through the use of derivatives.

Income taxes

Tax recorded in the income statement 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 under IAS 12. Calculation of deferred tax is done using the tax rate in effect at any time. 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.

A 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 under 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 the group's debt.

Subordinated debt and hybrid capital

Subordinated debt and hybrid capital issued before 2012 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. Hybrid Capital issued after 2012 have been classified as equity since these do not satisfy the definition of a financial liability in IAS 32. The bond is perpetual and SpareBank 1 SMN has the right to not pay interest to the investors. The interest will not be presented as an interest expense in the income statement, but as a reduction to equity. See also note 3 for a closer description. 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.

Contingent liabilities

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 SpareBank 1 SMN Group has a pension scheme for its staff that meet the requirements set for mandatory occupational pensions. SpareBank 1 SMN had a defined benefit scheme previously. This was terminated from 1 January 2017. The settlement gain was in accordance with IAS 19 taken to the income statement in 2016 when the decision was made. The Group employees transferred to a defined contribution scheme.

Defined contribution scheme

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 to the employees' collective pension savings. The future pension will depend on the size of the contribution and the annual return on the pension savings. The group has no further obligations related to employees' 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. Any pre-paid contributions are recognised as an asset (pension assets) to the extent the contribution can be refunded or reduce future inpayments.

The contributions are made to the pension fund for full-time employees, and the contribution is from 7 per cent from 0-7,1 G and 15 per cent from 7.1 – 12 G. The premium is expensed as incurred. See also note 24 Pensions.

Early retirement pension scheme ("AFP")

The banking and financial industry has established an agreement on an early retirement pension scheme ("AFP"). The scheme covers early retirement pension from age 62 to 67. 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 on 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 per cent of pensionable income capped at 7.1G 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 7.1G.

In keeping with the recommendation of the Norwegian Accounting Standards Board, no provision was made for the group's de facto AFP obligation in the accounting year. This is because the office that coordinates the schemes run by the main employer and trade union organisations has yet to perform the necessary calculations.

Segment reporting

SpareBank 1 SMN has Retail Banking and Corporate Banking, along with the most important subsidiaries and associates as its primary reporting segments. 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

Proposed dividends on equity 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 closing 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.

New or revised accounting standards approved but not implemented in 2017

Those standards and interpretations that have been adopted up to the date of presentation of the consolidated accounts, but whose entry into force is scheduled for a future date, are set out below. The group's intention is implement the relevant changes at the time of their entry into force, on the proviso that the EU approves the changes before presentation of the consolidated accounts.

IFRS 9 Financial Instruments

IFRS 9 Financial Instruments will replace IAS 39 Financial Instruments – Recognition and Measurement. IFRS 9 deals with recognition, classification, measurement and derecognition of financial assets and liabilities as well as hedge accounting. IFRS 9 will apply as from 1 January 2018 and is approved by the EU. For an overview of the quantitative impact of implementing IFRS 9, see note 45.

A description of new requirements under IFRS 9 and changes from earlier standards is set out below. That is followed by a description of the choices made by SpareBank 1 SMN and of the current status of the implementation project.

Classification and measurement

Financial assets

Under IFRS 9 financial assets are classified in three measurement categories: fair value with changes in fair value reported in profit/loss (FVPL), fair value with changes in fair value reported in other comprehensive income (OCI), and amortised cost. The measurement category is determined upon first-time recognition of the particular asset. For financial assets a distinction is drawn between debt instruments and equity instruments. The classification of financial assets is determined on the basis of contractual terms and conditions for the financial assets and the business model used to manage the portfolio of which the assets are a part.

Financial assets that are debt instruments

Debt instruments with contractual cash flows that are only payment of interest and principal on given dates and which are held in a business model whose purpose is to receive contractual cash flows shall in principle be measured at amortised cost. Instruments with contractual cash flows that are only payment of interest and principal on given dates and which are held in a business model whose purpose is both to receive contractual cash flows and sales shall in principle be measured at fair value with changes over OCI, with interest income, currency conversion effects and any write-downs reported in ordinary profit/loss. Fair value changes over OCI shall be reclassified to profit/loss upon the sale or other disposal of the assets.

Other debt instruments shall be measured at fair value with changes reported in profit/loss. This applies to instruments with cash flows that are not only payment of normal interest (time value of money, credit margin and other normal margins related to loans and receivables) and principal, and instruments held in a business model whose main purpose is not that of receiving contractual cash flows. The preliminary assessment is that designation of financial instruments at fair value will be at about the same level as today.

Derivatives and investments in equity instruments

All derivatives shall be measured at fair value with changes reported in profit/loss, but derivatives designated as hedging instruments shall be accounted for in keeping with the principles for hedge accounting. Investments in equity instruments shall be measured in the balance sheet at fair value. Value changes shall as a main rule be reported in ordinary profit/loss, but an equity instrument which is not held for trading purposes and is not a contingent consideration following a business transfer can be designated as measured at fair value with changes reported in OCI. Where equity instruments are designated at fair value with value changes reported in OCI, ordinary proceeds shall be reported in profit/loss, whereas value changes shall not be reported in profit/loss either on an ongoing basis or upon disposal.

Financial liabilities

For financial liabilities the rules are essentially the same as under today's IAS 39. As a main rule financial liabilities shall continue to be measured at amortised cost with the exception of financial derivatives measured at fair value, financial instruments forming part of a trading portfolio and financial liabilities accounted for at fair value with value changes recognised in profit/loss.

Hedge accounting

IFRS 9 simplifies the requirements on hedge accounting in that hedge effectiveness is linked more closely to the management's risk management and gives more scope for assessment. The requirement of hedge effectiveness of 80-125 per cent is removed and replaced with more qualitative requirements, including the requirement of an economic relation between the hedging instrument and the hedged object, and that credit risk shall not dominate the value changes in the hedging instrument. Under IFRS 9 a prospective effectiveness test is sufficient, whereas under IAS 39 hedge effectiveness must be considered both prospectively and retrospectively. Documentation of the hedging relationship is still required. The bank's assessment is that hedge accounting will be continued to approximately the same extent as today.

Loan impairment write-downs

Under current rules, IAS 39, impairment write-downs shall only be made in cases where there is objective evidence that a loss event has occurred since first-time recognition. Under IFRS 9, on the other hand, loss provisions shall be recognised based on expected credit loss (ECL). Measurement of the provision for expected loss depends on whether credit risk has increased significantly since first-time recognition. Upon first-time recognition, and when credit risk has not increased significantly since first-time recognition, provision shall be made for a 12-month expected loss. If credit risk has risen significantly, provision shall be made for expected loss across the entire life. The methodology in the IFRS 9 standard entails somewhat larger volatility in write-downs, and write-downs are expected to be made at an earlier stage than under current practice. This will be particularly noticeable at the start of a cyclical downturn.

Further description of the bank's future impairment write-down model

Loss estimates are to be prepared quarterly, and will build on data in the data warehouse which has historical accounting and customer data for the entire credit portfolio. Loss estimates will be computed based on 12-month and lifelong probability of default (PD), loss given default (LGD) and exposure at default (EAD). The data warehouse contains historical data for observed PD and observed LGD. In keeping with IFRS 9 the bank groups its loans in three stages.

Stage 1:

This is the starting point for all financial assets covered by the general loss model. All assets that do not have significantly higher credit risk than at first-time recognition receive a loss provision corresponding to 12 months' expected loss. All assets that are not transferred to stage 2 or 3 reside in this category.

Stage 2:

Stage 2 of the loss model encompasses assets that show a significant increase in credit risk since first-time recognition, but where objective evidence of loss is not present. For these assets a provision for expected loss over the entire lifetime is to be made. In this group we find accounts with a significant degree of credit deterioration, but which at the balance sheet date belong to customers classified as performing. As regards delineation against stage 1, the bank defines 'significant degree of credit deterioration' by taking a basis in whether the exposure's calculated probability of default shows a significant increase. SpareBank 1 SMN has decided to utilise both absolute and relative changes in PD as criteria for transfer to stage 2. The most important factor for a significant change in credit risk is the quantitative change in PD on the period end compared to the PD at first time recognition. A change in PD by more than 150 per cent is considered to be a significant change in credit risk. The change will have to be over 0.6 percentage points. In addition, customers with payments 30 days past due will be transferred to stage 2. A qualitative assessment is also done when engagements have been put on watch list.

Stage 3:

Stage 3 of the loss model encompasses assets that show a significant increase in credit risk since loan approval and where there is objective evidence of loss at the balance sheet date. For these assets a provision shall be made for expected loss over the entire lifetime. These are assets which under current rules are defined as defaulted and written down.

IFRS 15 Revenue from Contracts with Customers

The IASB and FASB have published a new converged standard for revenue recognition, IFRS 15 Revenue from Contracts with Customers, which replaces all existing standards and interpretations relating to revenue recognition. The core principle of IFRS 15 is that revenues are recognised in order to reflect the transfer of agreed goods or services to customers, and at an amount that reflects the compensation the company expects to be entitled to in exchange for such goods or services. The standard applies, with a small number of exceptions, to all remunerative contracts with customers and includes a model for recognition and measurement of sales of individual non-financial assets (for example sales of property, plant and equipment).

IFRS 15 will be implemented under either the full retrospective or modified retrospective method. The standard has accounting effect as from 1 January 2018. The standard will not have a significant impact on the group's principles for revenue recognition.

IFRS 16 Leases

The IASB published IFRS 16 in January 2016. The standard requires lessees to recognise assets and liabilities for the majority of leases in the same way as financial leases are accounted for under IAS 17 Leases. The lessee accounts for a "right to use asset" and an associated liability in the balance sheet. The asset is depreciated over the term of the lease, and the liability is measured at amortised cost. For lessors there are small changes relative to today's accounting standard, IAS 17 Leases.

Based on the leases entered into at 31 December 2017, the implementation of IFRS 16 would give a right-to-use asset of approximately NOK 110 million. The sale of SpareBank 1 SMN headquarter which is expected during first quarter of 2018 will result in a reduction of assets by NOK 600 million. The expected lease which will be entered into with the buyer of the property, will give a right to use asset in the balance sheet of approximately NOK 330 million when implementing IFRS 16 at 1 January 2019.