

# IFRS Introduction Meeting (Second Session)

April 9, 2013

Accounting & Finance Departments, Rakuten Inc.

<http://global.rakuten.com/corp/>

# Disclaimer

- In this presentation, FY2012 earnings are presented both in IFRS and J-GAAP. IFRS earnings are different with J-GAAP based figures.
- This presentation material includes expressions that are different with actual transactions and accounting treatment in order to facilitate readers' understanding.

# 1 : Financial Instruments - Overview

# Definition and Examples of Financial Instruments

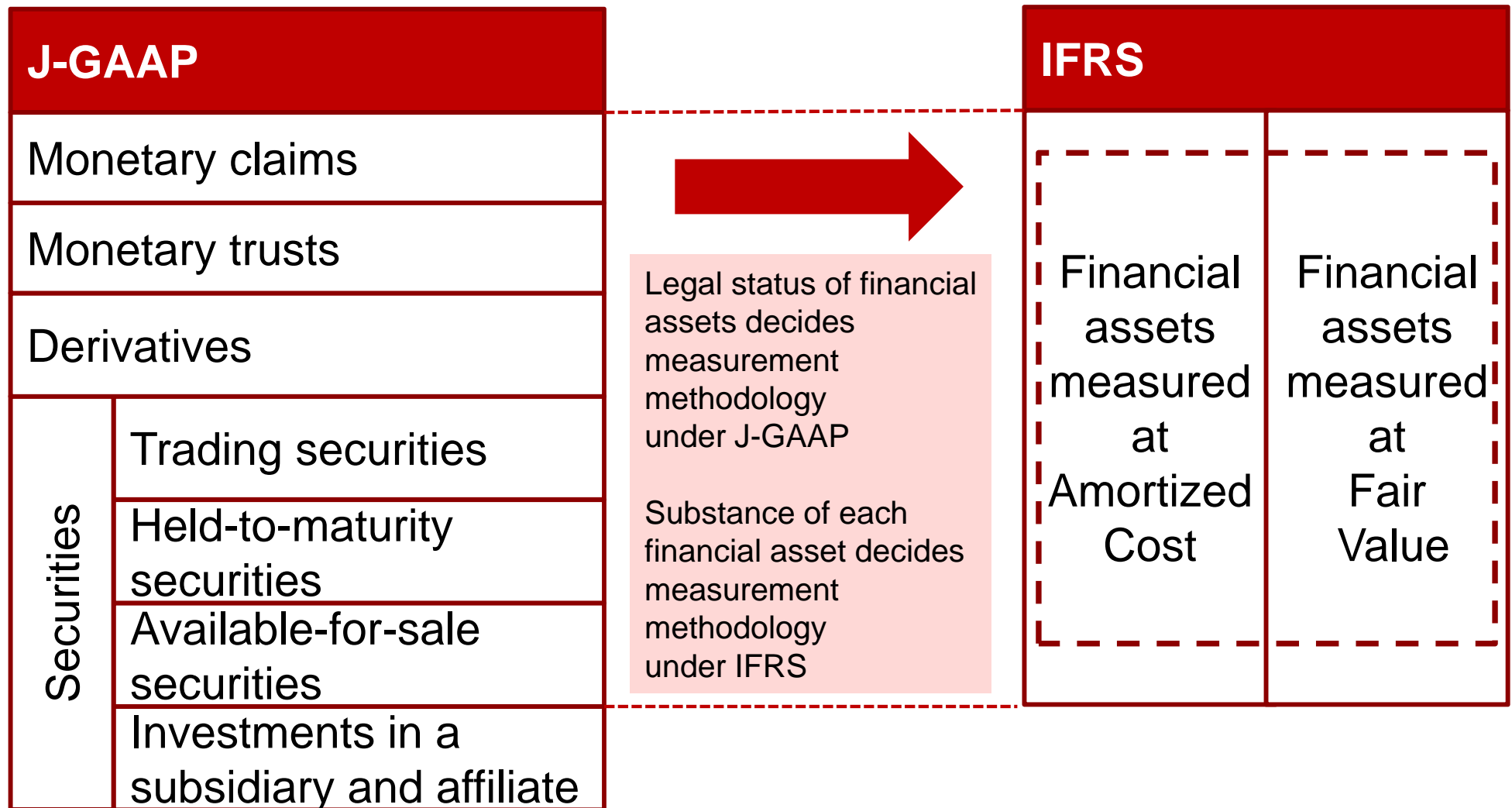
## Definition

A financial instrument is any contract that brings about a financial asset of one entity and a financial liability or equity instrument of another entity

## Examples

- A) Cash
- B) Equity instrument of another entity
- C) Contractual right:
  - i. to receive cash or another financial asset from another entity
  - ii. to exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the entity

# Classification of Financial Assets



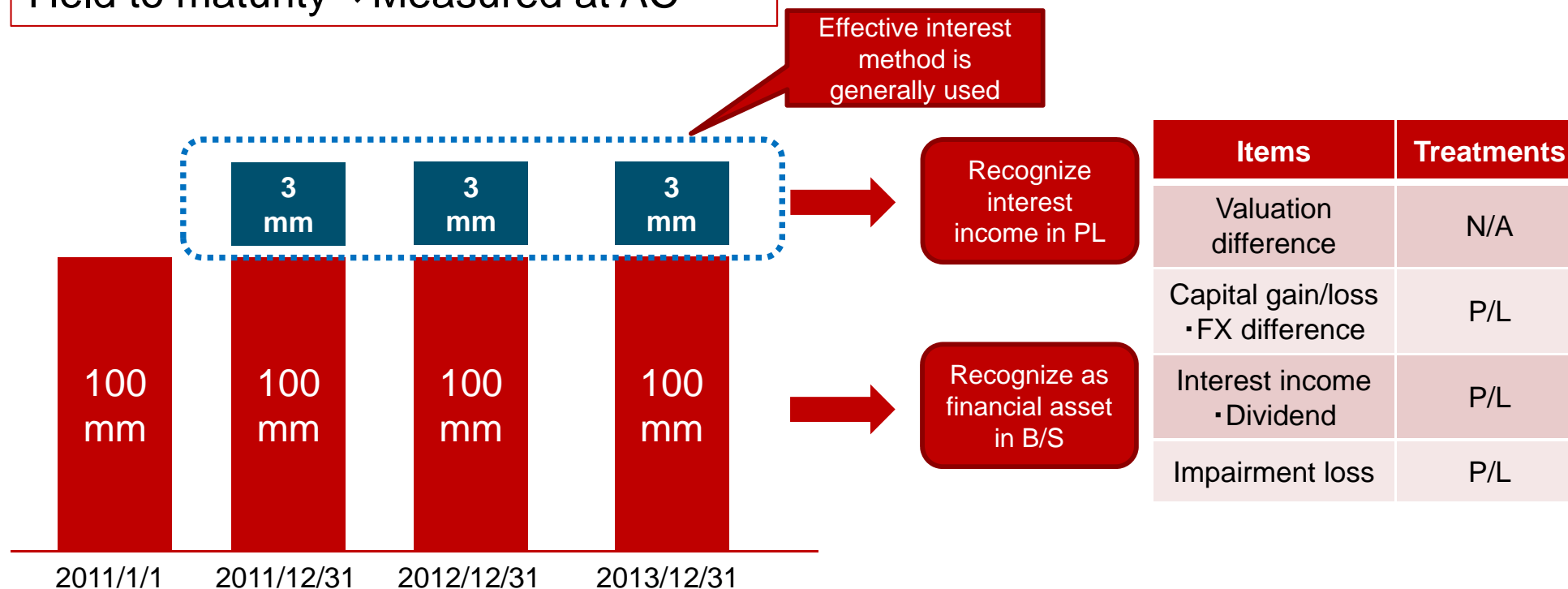
# Financial Assets Measured at Amortized Cost (AC)

Financial assets that meet following two conditions are measured at amortized cost

- The asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows
- The contractual terms of the instrument bring cash flows on a specified date that are solely payments of principal and interest on the principal amount outstanding

E.g. Acquired JPY100million of bonds with fixed coupon rate of 3% on Jan 1, 2011

Held to maturity ⇒ Measured at AC

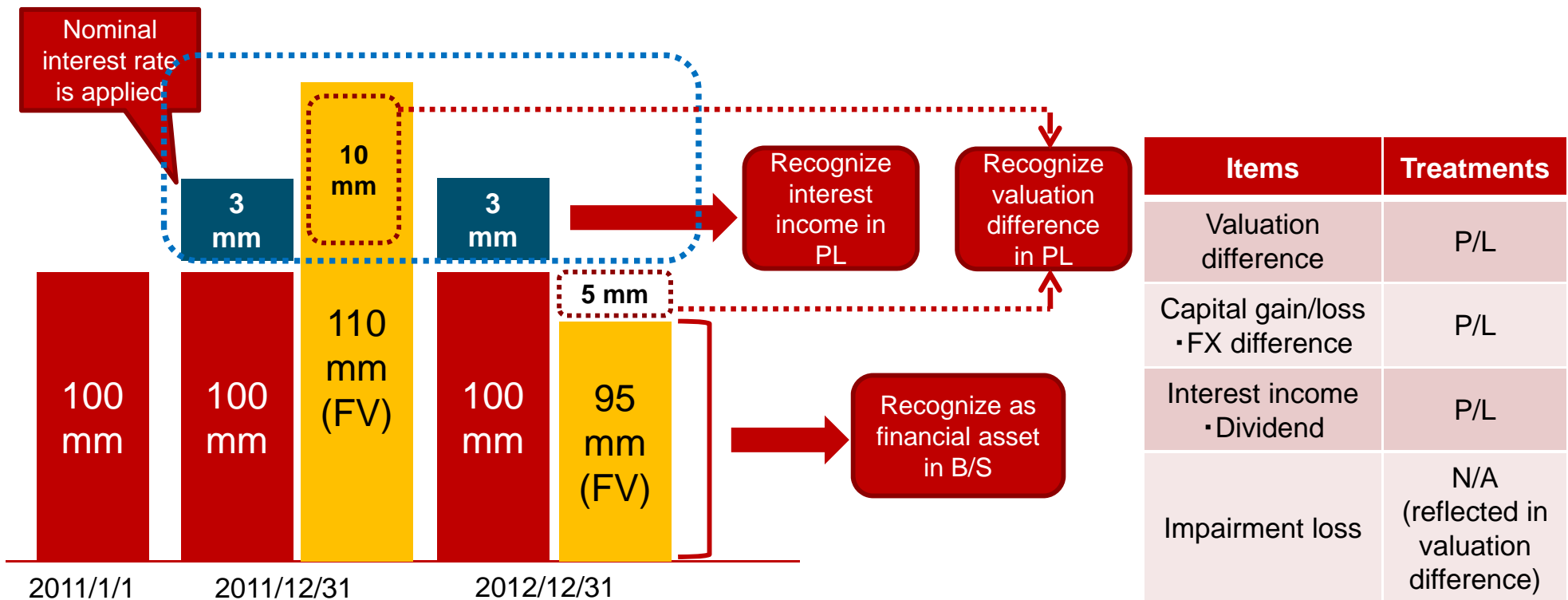


# Financial Assets at Fair Value Through Profit or Loss (FVtPL)

- Applied to financial assets that do not meet conditions about amortized cost such as debt instruments and equity investments
- Although FVtPL is standard measurement, it is possible to select FVtOCI by examining nature of each financial asset

E.g. Acquired JPY100million of bonds with fixed coupon rate of 3% on Jan 1, 2011

Not held to maturity ⇒ Measured at FVtPL

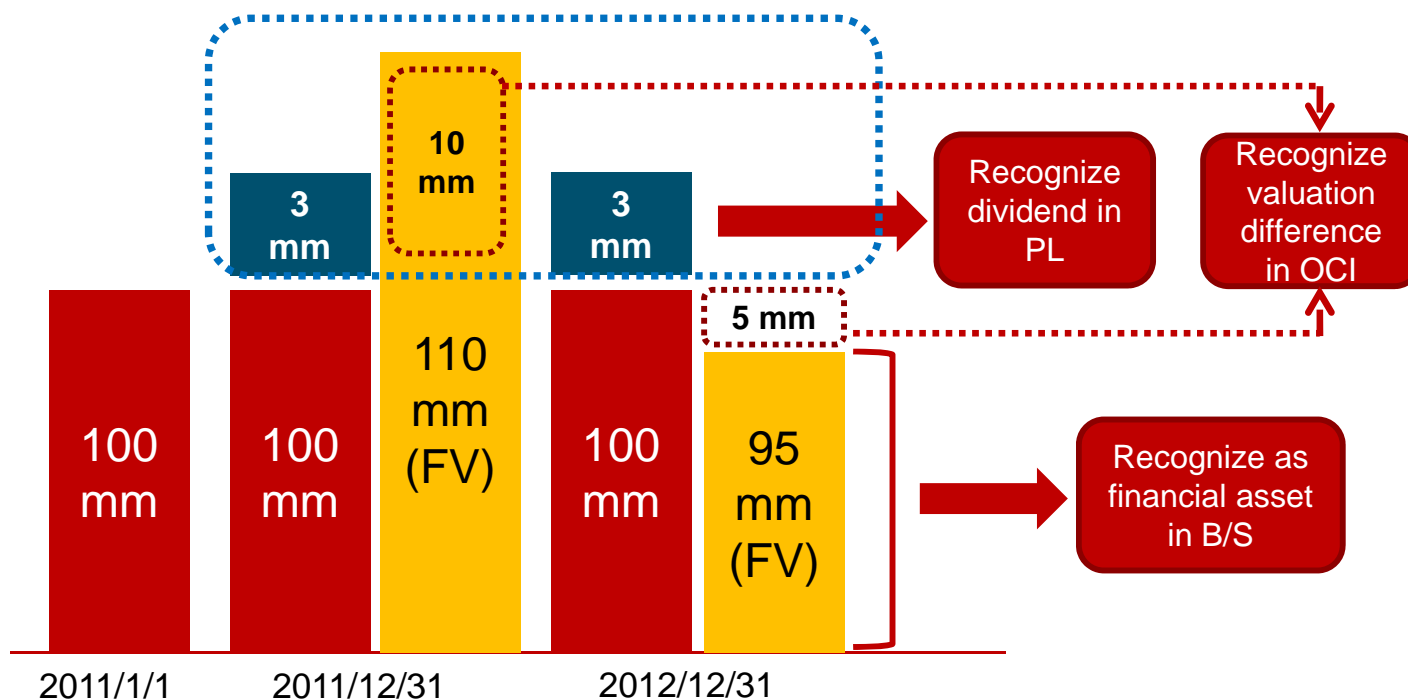


# Financial Assets at Fair Value Through Other Comprehensive Income (FVtOCI)

- Applied to financial assets that do not meet conditions about amortized cost such as equity investments
- Although FVtPL is standard measurement, it is possible to select FVtOCI by examining nature of each financial asset

E.g. Acquired JPY100million of listed equity on Jan 1, 2011

Choose to hold equity as FVtOCI



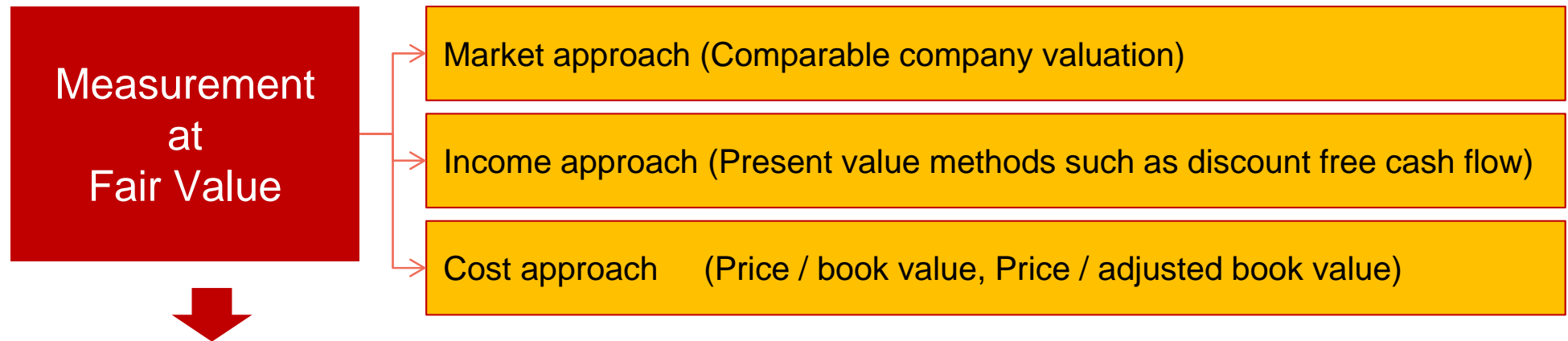
Items	Treatments
Valuation difference	OCI
Capital gain/loss • FX difference	OCI
Dividend	P/L
Impairment loss	N/A (reflected in valuation difference)



# AC, FVtPL and FVtOCI in Financial Statements

	AC	FVtPL	FVtOCI																														
B/S	<p>2011/12/31</p> <table border="1"> <tr> <td>Assets measured at AC 100mm</td> <td></td> </tr> </table>	Assets measured at AC 100mm		<p>2011/12/31</p> <table border="1"> <tr> <td>Assets measured at FVtPL 110mm</td> <td>Retained earnings 10mm</td> </tr> </table>	Assets measured at FVtPL 110mm	Retained earnings 10mm	<p>2011/12/31</p> <table border="1"> <tr> <td>Assets measured at FVtOCI 110mm</td> <td>Valuation difference 10mm</td> </tr> </table>	Assets measured at FVtOCI 110mm	Valuation difference 10mm																								
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# Measurement of Unlisted Equity



Cost is considered as fair value, when following criteria are met

- 1) Recent information to assess fair value is not sufficient; or
- 2) Range of possible fair values are wide,  
and cost is considered as best estimate within the range

Indications that cost does not reflect fair value are as follows

- 1) A significant change in the performance of the investee compared with budgets, plans or milestones
- 2) Changes in expectation that the investee's technical product milestones will be achieved
- 3) A significant change in the market for the investee's equity or its products or potential products
- 4) A significant change in the global economy or the economic environment in which the investee operates
- 5) A significant change in the performance of comparable entities, or in the valuations implied by the overall market
- 6) Internal matters of the investee such as fraud, commercial disputes, litigation, changes in management or strategy
- 7) Evidence from external transactions in the investee's equity, either by the investee (such as a fresh issue of equity), or by transfers of equity instruments between third parties

## 2: Rakuten's financial business

# Financial Assets held by Rakuten Group

Segments	Major Financial Assets	Accounting Items on Balance Sheet	Measurement
Banking	Trust beneficiary rights (excluding securitized assets by Rakuten Card)	Investment securities for banking business	AC / FVtPL
	Floating-rate domestic sovereign bonds	Investment securities for banking business	FVtPL
	Fixed-rate domestic sovereign bonds, domestic municipal bonds, foreign bonds and others	Investment securities for banking business	AC
	Loans (Loan receivables from private customers)	Loans for banking business	AC
Credit Card	Shopping receivables	Loans for credit card business	AC
	Revolving balances	Loans for credit card business	AC
Securities	Cash segregated as deposits	Financial assets for securities business	AC
	Margin transactions assets	Financial assets for securities business	AC
	Investment securities held for trading purposes	Financial assets for securities business	FVtPL
	Derivative assets held for trading purposes	Derivative assets	FVtPL
Insurance	Domestic sovereign bonds, municipal bonds, corporate bonds	Investment securities for insurance business	AC
Non-financial	Accounts receivable generated from sales relating to Internet Services business	Accounts receivable	AC
	Equity investments other than equity method investments	Investment securities	FVtOCI

# Floating-Rate Sovereign Bonds held by Rakuten Bank

## J-GAAP

- At time of acquisition of Rakuten Bank, Rakuten consolidated floating-rate sovereign bonds held by Rakuten Bank at market value (theoretical value)
- Book value recognized by Rakuten Bank was unchanged
- Bonds sales gains recognized by Rakuten Bank are adjusted in “Adjustments” segment in consolidated financial statements

## IFRS

- Difference between book value recognized by Rakuten Bank and market value on IFRS adoption date was directly reflected in net assets without being recognized in PL on IFRS adoption date
- After adoption date, change in market value is measured at FVtPL

Floating-rate sovereign bonds were completely sold in Q1/13

# GAAP Differences in FY2012 Balance Sheet

(JPY mm)

J-GAAP	Classification	Securities for banking business	Short-term investment securities / Investment securities	Total
	Held-to-maturity securities	23,549	6,849	30,398
	Trading securities	-	441	441
	Available-for-sale securities	405,126	13,535	418,661
	Total	428,676	20,825	449,500

\*: Excluding investment securities under J-GAAP which are treated as cash & cash equivalents under IFRS

Decrease as securitized beneficial interests are on-balanced

IFRS	Classification	Investment securities for banking business	Investment securities ex. banking business	Total	
	AC	251,184	7,639	258,823	Fixed rate sovereign bonds Municipal bonds Foreign bonds Beneficial interests etc.
	FVtPL	45,142	50	45,192	Floating rate sovereign bonds Foreign bonds Beneficial interests etc.
	FVtOCI	0	15,722	15,722	Pinterest and others
	Total	296,326	23,411	319,737	

# Decrease in Market Fluctuation Risk

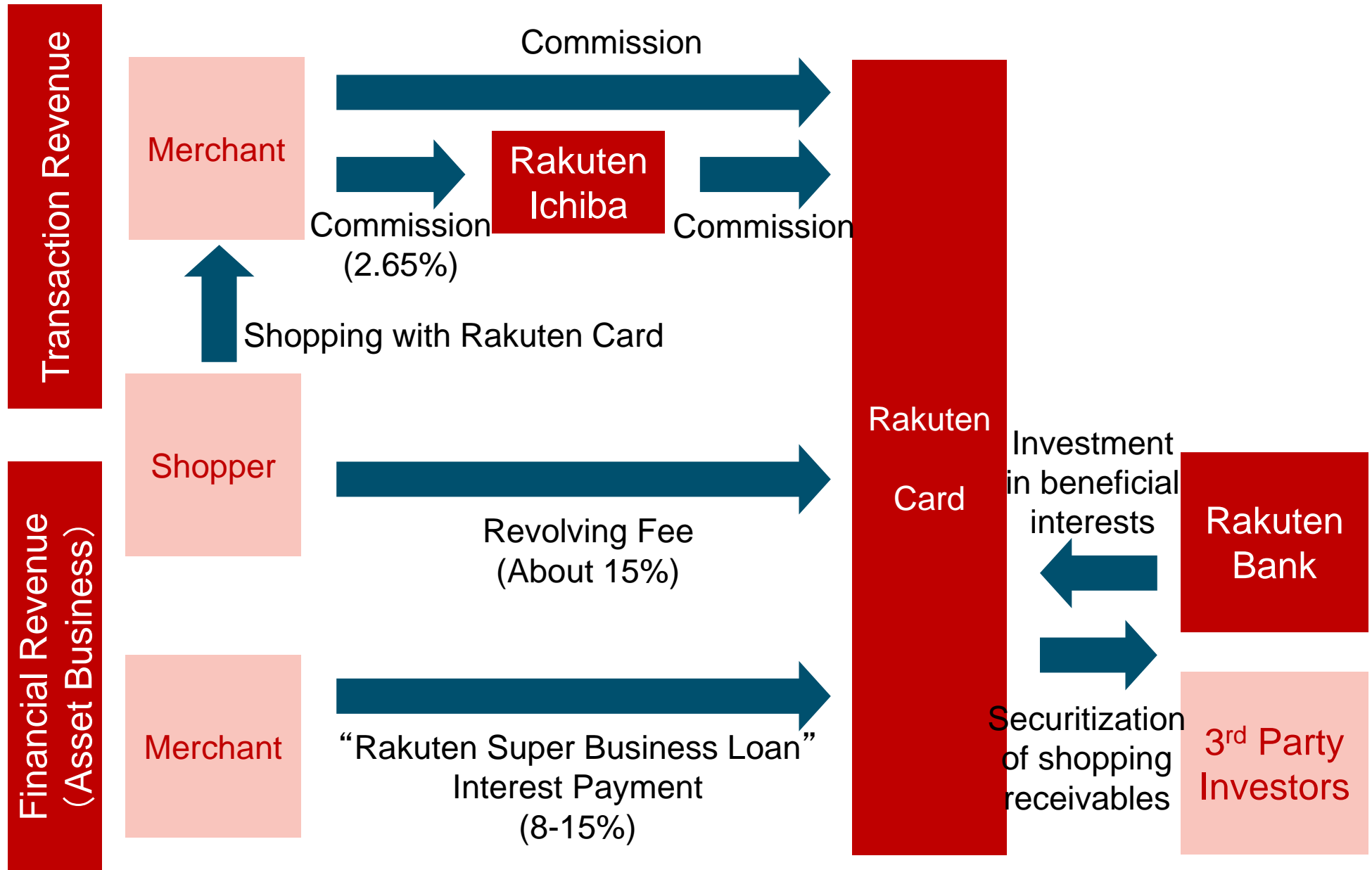
(JPY mm)

Investment securities for banking business	FY11 -Beg	FY11 -End	FY12 -End	Investment securities ex. banking business	FY11 -Beg	FY11 -End	FY12 -End
AC	290,224	269,596	251,184	AC	3	1,607	7,639
FVtPL	194,216	154,286	45,142	FVtPL	48,925	50	50
FVtOCI	90	72	0	FVtOCI	10,826	9,306	15,722
Total	484,530	423,954	296,326	Total	59,754	10,963	23,411

Despite IFRS's requirement of fair value recognition, PL impact caused by market fluctuation is declining

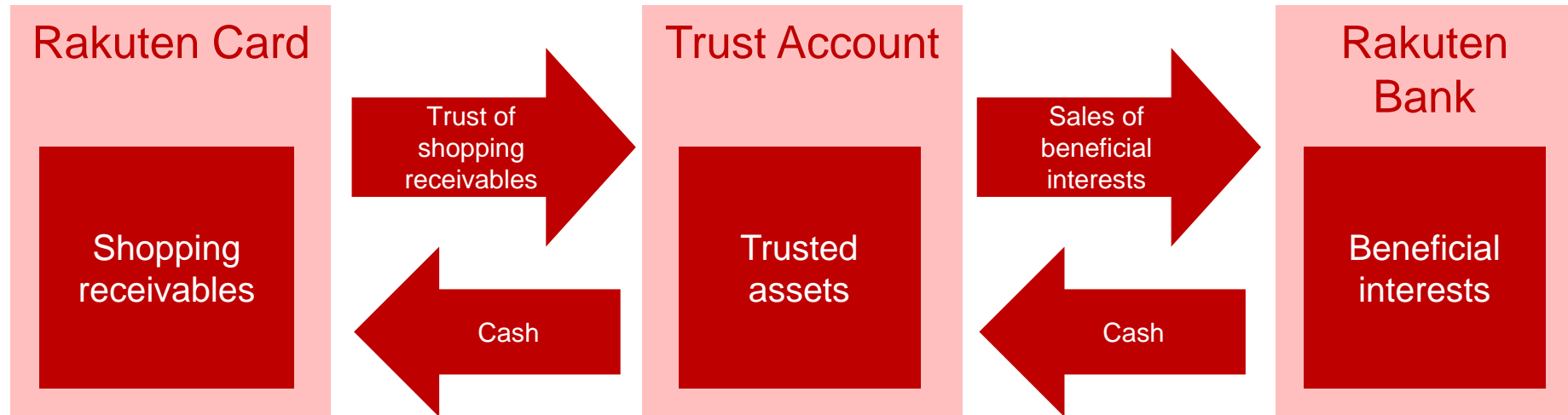
- Reduction of assets measured at FVtPL
- Increase in assets measured at FVtOCI

# Financial Flow within Rakuten Group





# On-balance of Securitized Assets (Revolving Balance)



## J-GAAP

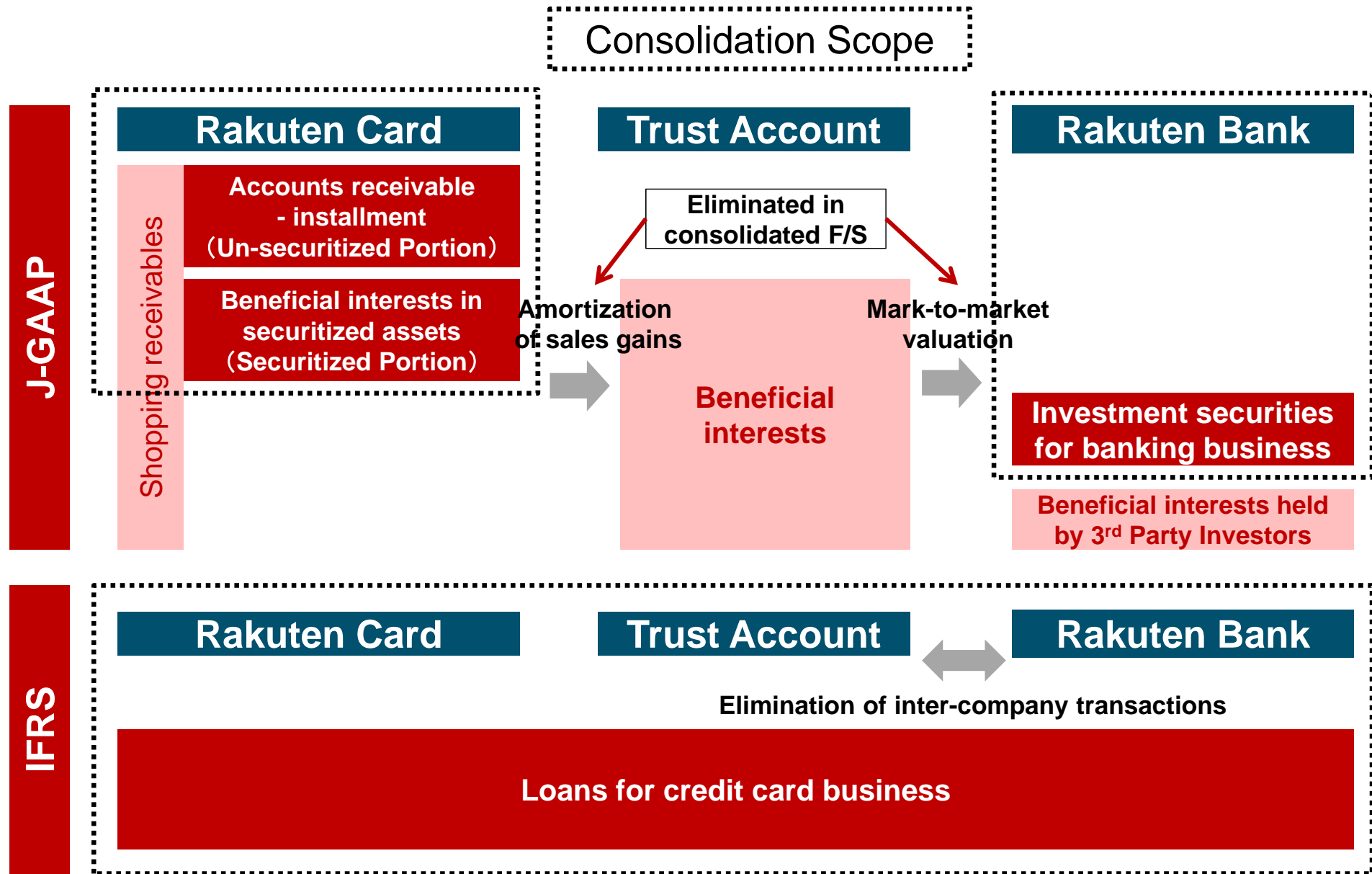
- Trust account is not consolidated
- Among securitized trust beneficiary interests, investments by Rakuten Bank remains on-balanced as “investment securities for banking business” in consolidated financial statements

## IFRS

- Trust account is consolidated
- Securitized assets are on-balanced as “loans for credit card business”

\*: Illustration above is one example of various securitization schemes

# Consolidated Accounting of Securitization (Revolving Balance)



# On-balance of Securitized Assets (Monthly-Cleared Balance)

## J-GAAP

- On-balance scheme is major securitization method
  - ✓ Migrating from off-balance to on-balance scheme since Q2/12

## IFRS

- Securitized assets are on-balanced

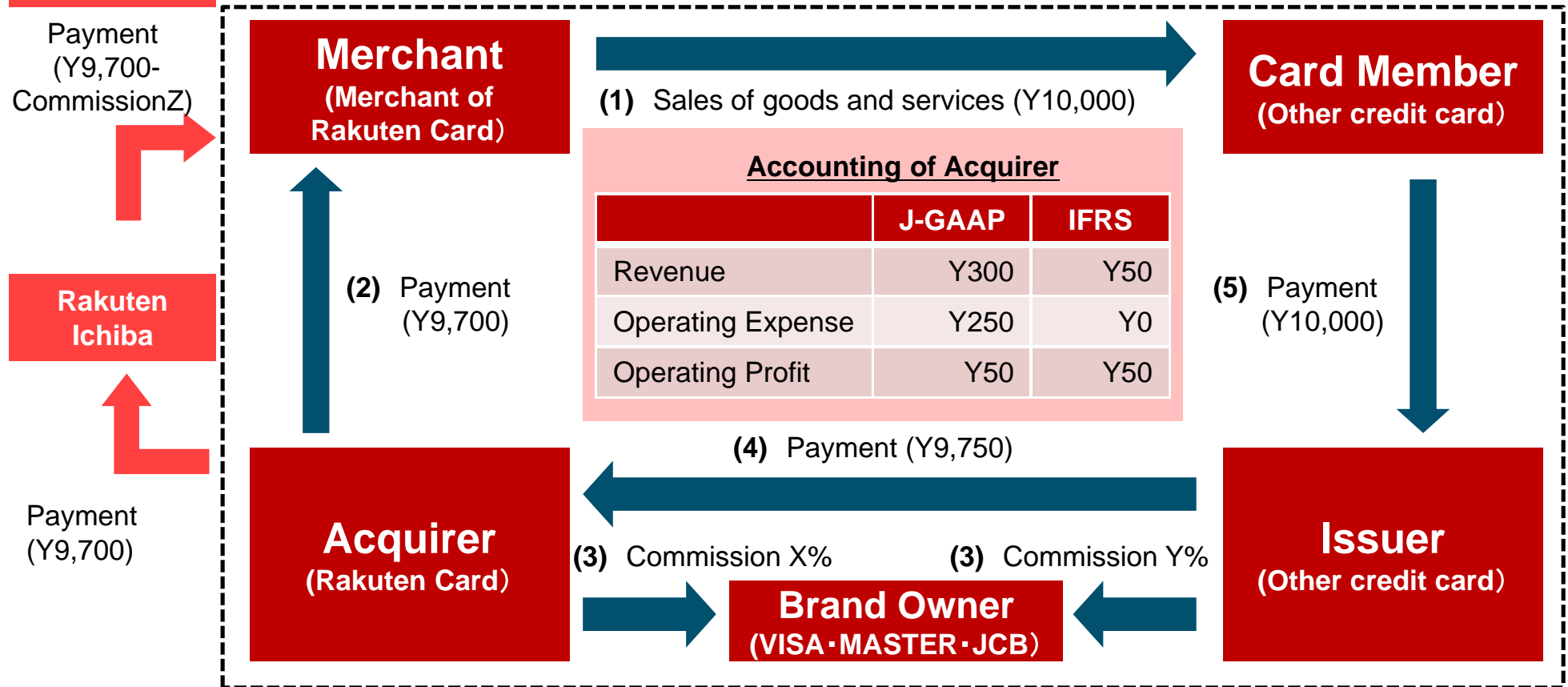
Differences in securitization impact  
of monthly-cleared balance  
between J-GAAP and IFRS are limited

# Net Reporting of Acquiring Revenue

Case: Sale at Rakuten Ichiba

E.g.

- Customer pays Y10,000 with credit card issued by 3<sup>rd</sup> party at merchant of Rakuten Card
- Assumption: Acquirer's fee Y50, Issuer's fee Y250, Total fee Y300



\*: Flowchart is illustrative, Figures are example

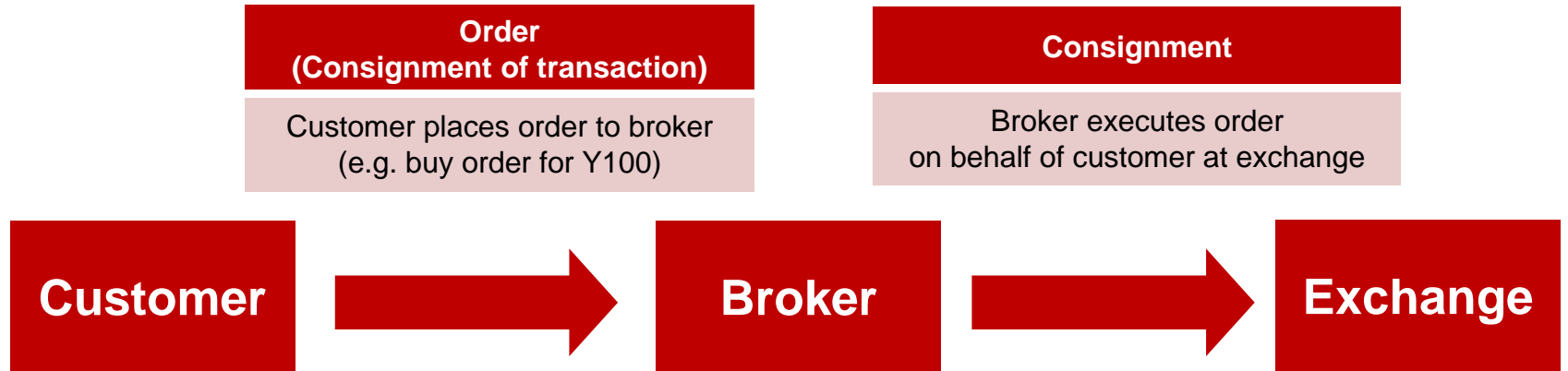
Case:  
Rakuten Card  
as Issuer

Recognize additional commission fee of Y250  
(Direct transaction with merchant)

# Gross-Up of Agency Transactions

## Agency Transactions

Transaction in which a broker acts only as an agent for the customer



## J-GAAP

Because economic benefit does not belong to broker in case of agency transaction, J-GAAP does not require journal entry of the rights/obligations, but requires to recognize commission revenue receivable on execution date, which is settled in 4<sup>th</sup> operating day after execution

## IFRS

Broker acquires right to receive equity from exchange and owes obligation to pay cash to exchange on 4<sup>th</sup> operating day after execution  
**Equity 100 / Account Payable 100**

Since economic benefit belongs to customer, broker has right and obligation to customer at the same timing  
**Account Receivable 100 / Equity 100**

# Gross-Up of Agency Transactions

Recognition of account receivables and payables for agency transactions		Buy order from customers	Sell order from customers	Net payment with JSCC
		Settlement on X day	Y100million	Y75million

**Net Settlement**

## Relationship with clearing organization

- Japan Securities Clearing Corporation (JSCC) conducts clearing operation of equity in Japan
- JSCC offsets rights and obligations of sellers and buyers on each settlement date

## Relationship with customer

- Net settlement between customer and broker is prohibited for spot transactions
- Gross settlement is presumed in journal entry

Accounts receivable relating to investment securities transactions (uncollected amount from customers)	100 /	Accounts payable relating to investment securities transactions (net payment to JSCC)	/ 25
		Accounts payable relating to investment securities transactions (unpaid amount to customers)	/ 75

## Recognition of 3 days of account receivables and payables that are unsettled on FY-End date

Market environment before FY-end date significantly impacts on balance of accounts receivable and payable

There is NO PL impact

## 3: Impairment Test and Others

# Treatment of Goodwill

J-GAAP		IFRS
Non-Consolidated	Consolidated	
Impairment of Equity in Subsidiary	Impairment of Goodwill	Impairment of Goodwill
<ul style="list-style-type: none"> <li>◆ Impair in case of significant drop in fair value</li> <li>◆ Consider future probability of recovery by examining achievement of budget</li> </ul>	<ul style="list-style-type: none"> <li>◆ Periodically amortize with straight-line or other method over 20 years or less</li> <li>◆ <u>Conduct impairment test if there is indication of impairment</u></li> <li>◆ <u>Undiscounted</u> CF is used for impairment test</li> </ul>	<ul style="list-style-type: none"> <li>◆ Amortization is prohibited</li> <li>◆ <u>Conduct impairment test once a year at same time each year, regardless of indication of impairment</u></li> <li>◆ Additional impairment test, if indication of impairment exists</li> <li>◆ <u>Discounted</u> CF is used for impairment test</li> </ul>



# Indication of Impairments

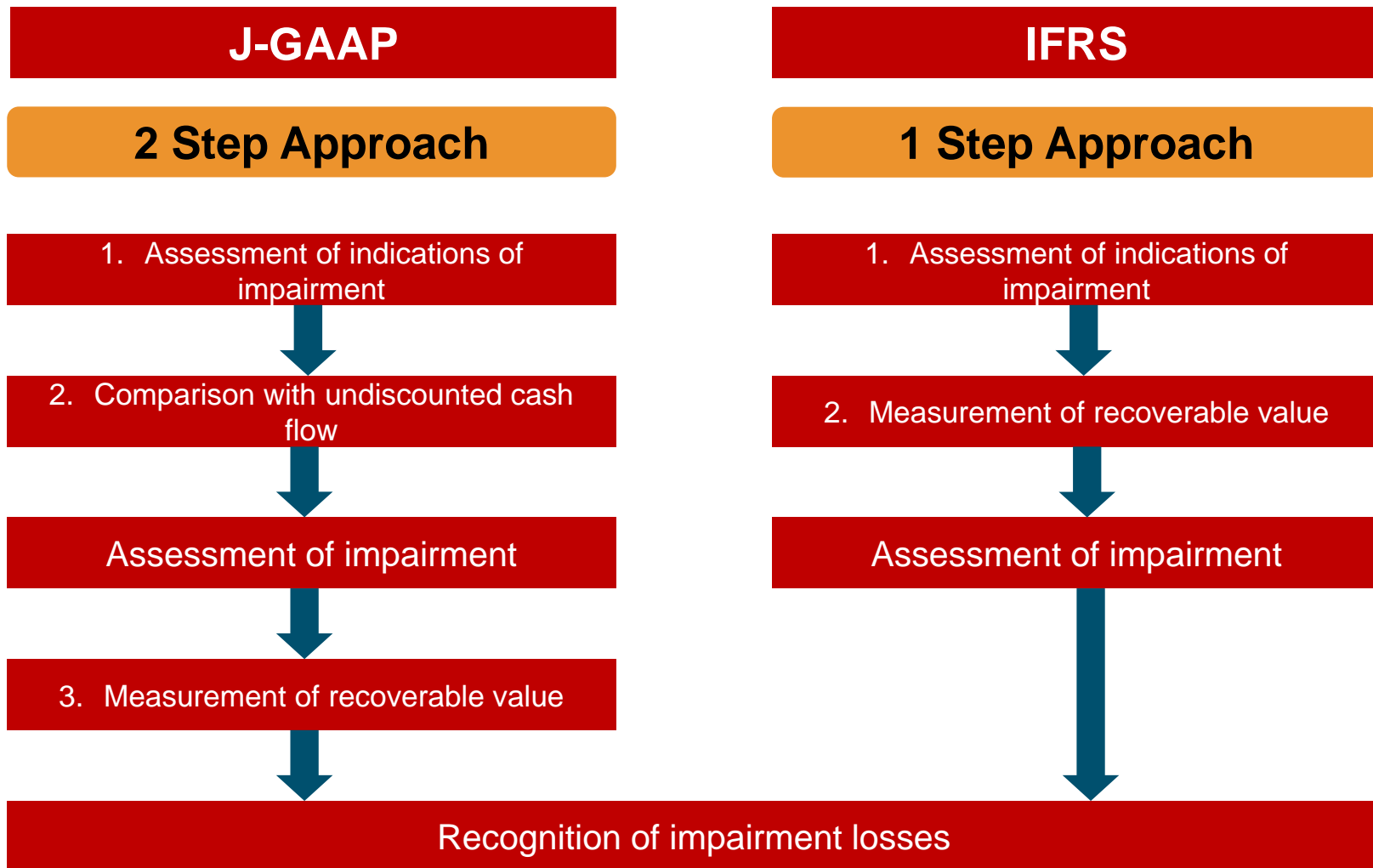
## External Factors

- Significant drop in market value of assets
- Significant deterioration of technology, economy or legal environment

## Internal Factors

- Obsolescence or physical damage of assets
- Termination or restructuring of business
- Significant deterioration of budget or business performance

# Process of Impairment

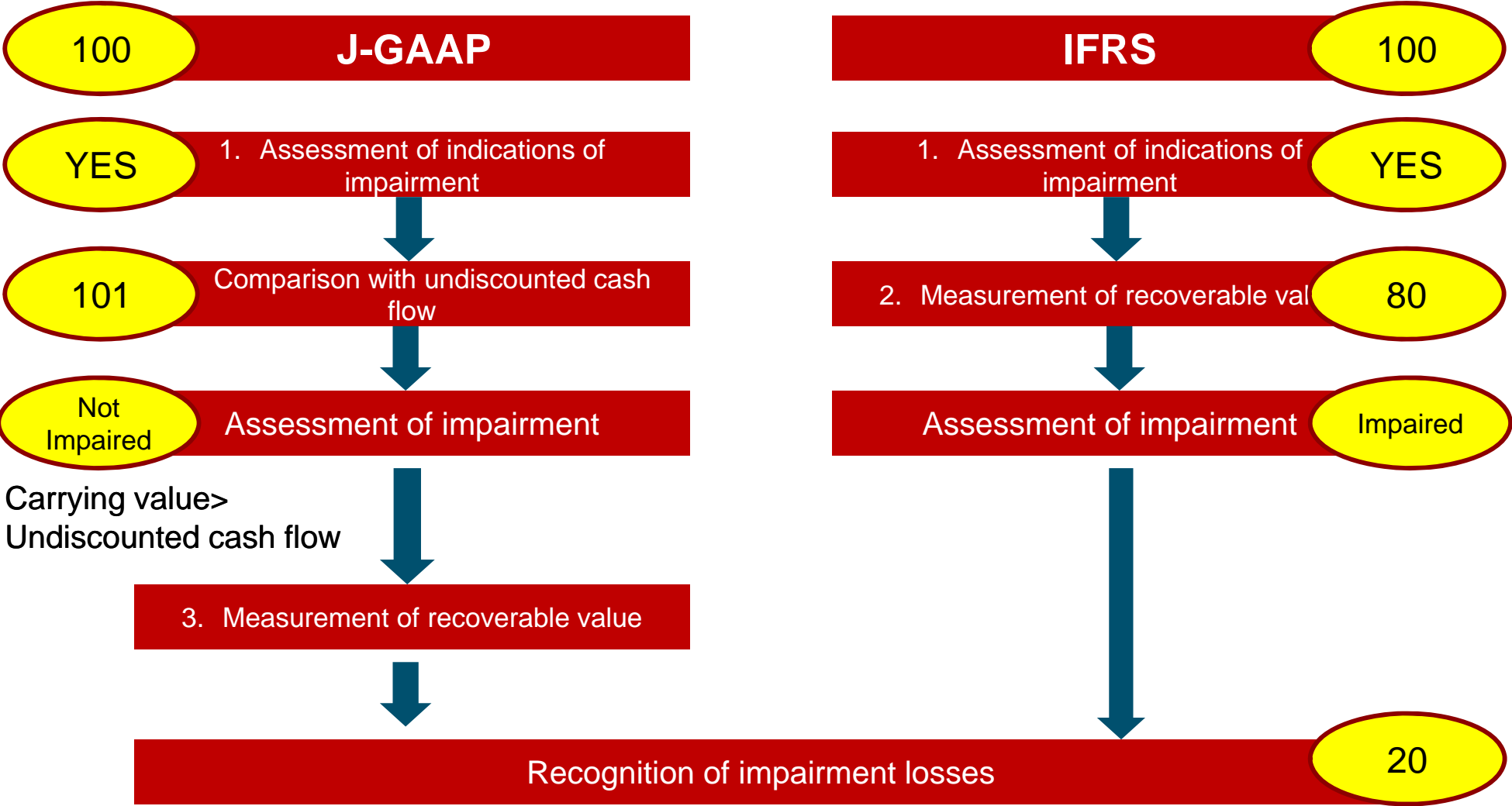


Impairment loss recognized under IFRS is generally larger than one recognized under J-GAAP, since undiscounted cash-flow analysis is allowed under J-GAAP

# Process of Impairment

## Example

- ✓ Carrying value: Y100
- ✓ Indication of impairment: Yes (Negative operating cash flows)
- ✓ Undiscounted cash flow: Y101
- ✓ Recoverable value: Y 80



# Balance of Goodwill and Intangible Assets (End of Dec 2012)

(JPY mm)

Cash Generating Unit	Balance		Perpetuity Growth Rate	Discount Rate
	Goodwill	Non-depreciable intangible assets*		
Internet Services	58,736	5,871		
PRICEMINISTER S.A.S.	12,273	5,110	2%	12.3%
Kobo Inc.	17,483	29	2%	14.5%
Others	28,980	732	2%~5.5%	8.6%~25.3%
Internet Finance	45,973			
Rakuten Bank	34,386		2%	11.8%
Others	11,587		2%	7.4%~14.6%
Others	3,186		2%	9.1%~9.6%
<b>Total</b>	<b>107,895</b>	<b>5,871</b>		

\*: Excluding depreciable intangible assets

# Deferred Tax Assets (Rakuten Card)

## Deferred Tax Assets (B/S)

(JPY mm)

	Beg of Jan 2011	End of Dec 2011	End of Dec 2012
J-GAAP	19,730	14,764	11,399
IFRS	25,105	17,670	13,601
Differences	5,375	2,906	2,202

1) Collectability other than deficit	3,387	752	65
2) Collectability of cumulative deficit	-	1,485	285
3) GAAP differences	1,988	669	1,852

1) Under J-GAAP, Rakuten Card recognizes deferred tax assets for taxable items that can be scheduled for five years ahead. Under IFRS, probabilities of future taxable income are also considered in addition to tax scheduling

2) Based on principle 1), collectability of cumulative deficit is maximum 5 years under J-GAAP, while IFRS can extend to available period of cumulative deficit (either 7 or 9 years)

3) Major GAAP differences are consolidation of SPE (valuation gain at securitization is taxable income) and deferral of annual membership fee (taxable income at receipt)

 **Rakuten**

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