IFRS Conference: São Paulo

Monday 15 April 2013

Special Interest Sessions (pre-conference)

Investor focused IFRS update

To assist investors and investor relations to prepare to analyse IFRS financial statements including those IFRSs that become effective for the first time in 2013.

09:00 ***Registration and refreshments***

09:30 ***Introduction***
Stephen Cooper
Member
IASB

09:35 ***Investor-focused IFRS update and Q&A***
Michael Wells
Director of Education Initiative
IASB

Guillermo Braunbeck
Project Manager
IASB

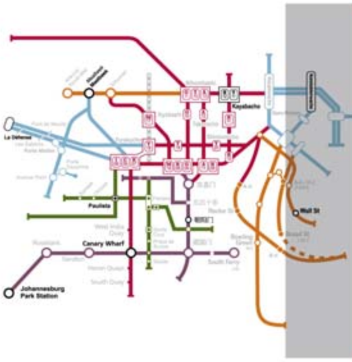
Reginaldo Alexandre
Chairman
APIMEC

11:55 ***Concluding comments***
Stephen Cooper
Member
IASB

12:00 ***Close of session***

April 2013

International Financial Reporting Standards



Atualização em IFRS para investidores

Investor focused IFRS update

Actualización en NIIF para inversores

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

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Who we are

- IASB
  - Guillermo Braunbeck, Project Manager, IASB
  - Mike Wells, Director, IASB
  - Stephen Cooper, IASB member
- Investors perspective:
  - Reginaldo Alexandre, President, Apimec

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How will this session work?

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- For each topic:
  - presentation of requirements
    - IFRSs mandatory for first time in 2013
    - other IFRS requirements (significantly different from BR GAAP before Law 11,638)
  - issues for investors
    - global view: including Citi Research report
    - Brazil investor's view
  - questions and answers

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Main new requirements effective 2013

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- Consolidation, joint arrangements and disclosures
- Fair value measurement

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Consolidation, joint arrangements and related disclosures

- Why consolidating financial statements?
- IFRS 10 → one single approach for consolidation, based on control.
- Control means...
  - power
  - exposure to variable returns
  - link between power and returns

Example 1: rights

- An investor acquires 48% of the voting rights of an investee.
- Remaining voting rights held by thousands of shareholders, with less than 1% each
- Based on the relative size of the other shareholders, investor concluded that a 48% interest would be sufficient to give it control.

Example 2: rights

- Investor A holds 40% of the voting rights of an investee.
- Twelve other investors each hold 5% of the voting right.
- Shareholder agreement: investor A has the right to appoint, remove and set the remuneration of management responsible for directing the relevant activities. Two-thirds majority vote of the shareholders is required to change the agreement.

Example 3: relevant activity

- Two investors (A and B) form an investee to develop and market a medical product.
- Investor A: in charge of developing and obtaining regulatory approval of the medical product.
- Once the regulator has approved the product, investor B will manufacture and market it.
- Obtaining regulatory approval and patent for the product has significant uncertainty and effort required. Patent provides exclusive manufacturing and marketing rights over a period of ten years.
- Business plan: ten-year period of exclusivity corresponds to 95% of the fair value of the patent

Consolidation, joint arrangements and related disclosures continued

- IFRS 11 → joint arrangements
  - joint operation: reporting company is exposed to the rights and obligations of underlying assets/liabilities. Investor recognises 'gross'
  - joint venture: rights to net assets. Investor recognises 'net' (equity method)
- Proportionate consolidation is no longer permitted

Issues for investors

- Joint arrangements → potential impact on
  - EV/EBITDA
  - gearing
- Changing to equity method from proportionate consolidation may give less favourable impression of the results, cash flow or financial position (eg lower margins, lower cash flow, or higher net debt)
- No effects expected on EPS or net asset value
- Enhanced disclosures

Issues for investors in Brazil

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Fair value measurement

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- IFRS 13 sets out *how* to determine fair value
  – other IFRSs specify where fair value applies
- Improved definition of fair value
- Hierarchy to determine fair value (Levels 1, 2 and 3)
- Valuation techniques

IFRS 13's 'new' definition of fair value

New fair value definition	Comments
… the price that would be received to sell an asset	sale of asset
or paid to transfer a liability	transfer of liability
in an orderly transaction	not forced/distressed sale
between market participants	market-based measure
at the measurement date.	specifies when sale or transfer takes place

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How do we arrive to a market-based measurement?

Quoted price in active market for an identical asset or liability?

Yes → Use quoted price to measure fair value (Level 1) → Must use without adjustment

No → Use valuation technique* to replicate market price →
- Level 2: no significant unobservable inputs‡
- Level 3: significant unobservable inputs‡

* Valuation techniques include the market approach, income approach and cost approach.

\+ Maximise the use of *relevant* observable inputs and minimise the use of unobservable inputs. Observable inputs include market data (prices and other information that is publicly available).

‡ Unobservable inputs include the entity's own data (budgets, forecasts) which must be adjusted if market participants would use different assumptions.

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Selecting a valuation technique

	Market approach available market price	Income approach (eg discounted cash flow) • directly identifiable cash flows	Cost approach (eg replacement cost) • not directly income producing • no identical market price • price needs adjustment
Level 1	• Price for identical item • Must use without adjustment		

Level 2	• Price needs adjustment
	• Observable inputs
		• Observable inputs
		  • rare
			• Observable inputs
			  • rare

Level 3	• Price needs adjustment • Unobservable inputs	• Unobservable inputs	• Unobservable inputs

Issues for investors

- FV accounting continues to be controversial (particularly in illiquid markets)
- IFRS 13 adoption may be a catalyst for some banks to adjust valuation methodologies
  - – OTC liabilities: inconsistent valuation particularly of own credit risk
  - – IFRS 13 plainly requires companies to incorporate non-performance risk (including a company's own credit risk)
  - – Standard is clear that credit risk should be on the basis of current market inputs.

Issues for investors in Brazil

Other IFRS requirements

- Presentation of financial statements and disclosure, accounting policies, changes in estimates and errors
- Business combinations
- Financial instruments
- Share-based payment

Presentation, accounting policies, changes in estimates and errors

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- Complete set of financial statements include:
  - Statement of cash flows
    - Replaces DOAR
    - Methods: direct and indirect
  - Statement of comprehensive income
    - No 'extraordinary' items
    - No requirement for 'operating profit' subtotal
  - Comprehensive disclosures
- Changes:
  - Accounting policies or errors: retrospective
  - Estimates: prospective

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Issues for Investors

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- Attention to comparability
  - Key metrics such as operating margin
  - Non-recurrent items
- Cash flows
  - Inconsistent starting point (eg net income, operating profit)
  - No net debt reconciliation
  - Operating profit and cash flow from operating activities may not be comparable
- Changes:
  - Restatements → possible 'red flag'

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Issues for investors in Brazil

Business combinations

- Acquistion method
  - An acquirer must be identified
  - Acquired business → assets/liabilities at FV
  - Goodwill: residual approach
- Price ‘paid’ for the acquisition
  - Measured at acquisition date
  - Includes estimated FV of ‘earn-outs’
- Goodwill
  - No longer amortised (tested annually for impairment)
  - ‘Negative goodwill’ → recognised in P&L

Issues to investors

- FV write-downs:
  - Increased future profits
  - Increased goodwill (not amortised)
  - Not visible
- Earn-outs MtM
  - Change in FV of contingent consideration → P&L
  - Can outweigh good performance
- Non-controlling interest

Issues for investors in Brazil

Financial instruments

- FV measurement for many instruments (eg derivatives, trading financial assets)
- Option to measure financial liabilities at FV:
  - eliminate/reduce mismatch
  - management and performance evaluated on FV basis
- Financial assets which are not measured at FV through P&L are tested for impairment. Assets are impaired if there is objective evidence that a 'loss event' has occurred.
- Hedge accounting

Issues to investors

- Comparability when there is option
- Counterintuitive P&L effects → when company's own debt credit risk deteriorates, a gain would be recorded
- Impairment requirements not consistently applied and 'incurred loss' model is 'too backward-looking'

Issues for investors in Brazil

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Share-based payment

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- Shares and options paid in exchange of goods or services (eg employees) have to be recognised at the FV of services/goods received by the entity.
- When measurement of the services or goods received is not reliably measurable, FV of the equity instrument is used as proxy.
- FV is measured at the date of grant and is not remeasured subsequently.
- Expense is charged to the P&L evenly over the vesting period.

Issues to investors

- Options and shares distributed are a form of employee pay
- Future estimated cash flows should take into account the total expected employee cost (even if some of the remuneration may be paid in the form of shares or options)
- FV of already outstanding options should be estimated and deducted (like debt) from the calculated EV when estimating the equity value of the business.
- Sensitivity to assumptions
- Diluted EPS

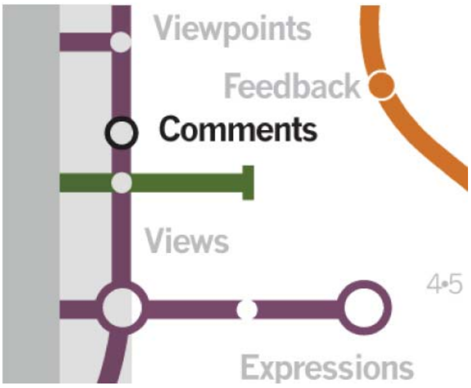
Issues for investors in Brazil

Other issues

- Rate regulated activities
- Revenue recognition
- Biological assets
- Service concession arrangements

Issues for investors in Brazil

Thank you



Expressions of individual views by members of the IASB and its staff are encouraged.

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