**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**
Who we are

• IASB
  – Guillermo Braunbeck, Project Manager, IASB
  – Mike Wells, Director, IASB
  – Stephen Cooper, IASB member
• Investors perspective:
  – Reginaldo Alexandre, President, Apimec
How will this session work?

• 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

Main new requirements effective 2013

• Consolidation, joint arrangements and disclosures
• Fair value measurement
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 (e.g. 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

Fair value measurement

- 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**

…the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

**Comments**

- Sale of asset
- Transfer of liability
- Not forced/distressed sale
- Market-based measure
- 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

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* 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.
### Selecting a valuation technique

<table>
<thead>
<tr>
<th>Market approach</th>
<th>Income approach</th>
<th>Cost approach</th>
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<tbody>
<tr>
<td>Available market price</td>
<td>(eg. discounted cash flow)</td>
<td>(eg. replacement cost)</td>
</tr>
<tr>
<td>• Price for identical item</td>
<td>• directly identifiable cash flows</td>
<td>• not directly income producing</td>
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<tr>
<td>• Must use without adjustment</td>
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<td>• no identical market price</td>
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<td></td>
<td>• Observable inputs</td>
<td>• price needs adjustment</td>
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<tr>
<td>Level 1</td>
<td>• rare</td>
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<td>• Unobservable inputs</td>
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### 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

• 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

Issues for Investors

• 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’
Issues for investors in Brazil

Business combinations

- Acquisition method
  - An acquirer must be identified
  - Acquired business $\rightarrow$ 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’ $\rightarrow$ 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**

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**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’
Share-based payment

- Shares and options paid in exchange of goods or services (e.g., 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
Expressions of individual views by members of the IASB and its staff are encouraged.

The views expressed in this presentation are those of the presenter. Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.

Thank you