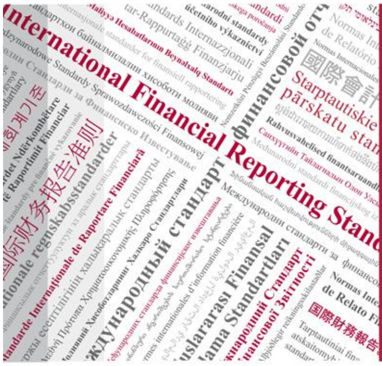
21 November 2012

International Financial Reporting Standards



IFRSs as Global Accounting Standards

EMC Annual Meeting 2012
Santiago de Chile

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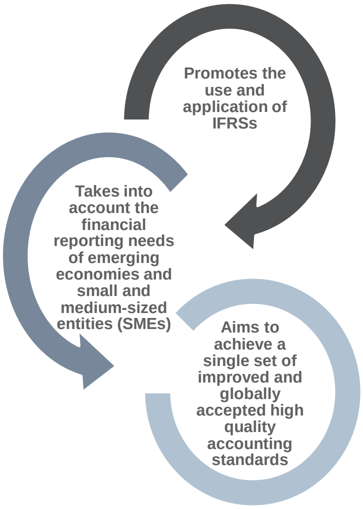
International Financial Reporting Standards

Who are we?

IFRS™

Who are we?

The **International Accounting Standards Board** (IASB) is the standard-setting body of the **IFRS Foundation**, an independent organisation that:



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Why Global Accounting Standards?

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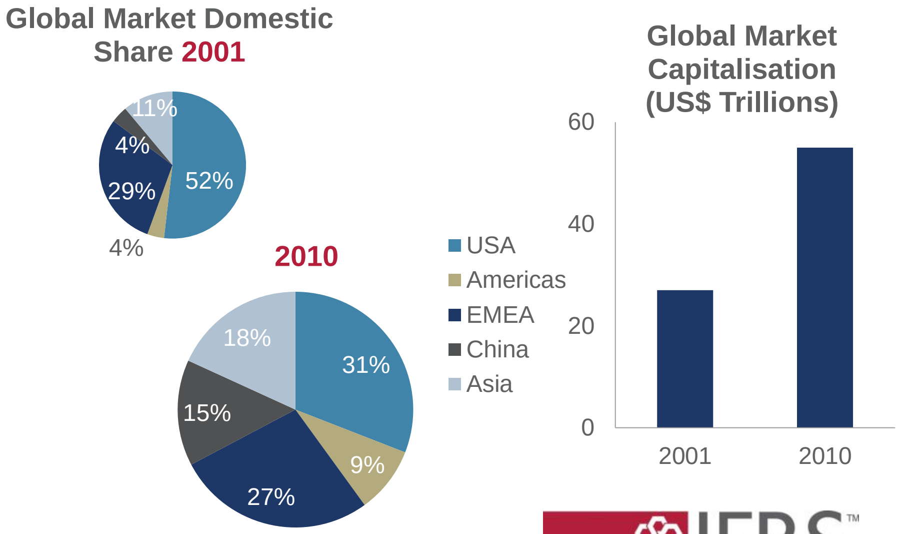
Reasons for adopting IFRS

- Global markets require global standards. Economies now transcend national borders.
- Capital market participants have higher quality information and can make better decisions.
- Markets allocate funds more efficiently and firms achieve a lower cost of capital.

> **"We reaffirm our objective to achieve a single set of high quality global accounting standards"**
>
> **G20 Leaders Communique, Cannes 2011**

Global markets: growing & diversifying



Progress towards global accounting standards

- 100+ countries now require or permit IFRS
- From 2012, $^3/_4$ **of G20 require IFRS**

G20 Members requiring use of IFRS	Adoption year
Argentina	2012
Australia	2005
Brazil	2010
Canada	2011
European Union	2005
France	2005
Germany	2005
Italy	2005
Mexico	2012
Republic of Korea	2011
Russia	2012
South Africa	2005
Turkey	2005
United Kingdom	2005

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Ensuring success

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IFRS: just one piece of the puzzle

Learning from others: EU implementation of IFRS(1)

- Broad agreement that **quality** of financial reporting **improved**.
- Widespread agreement that financial statements are **easier to compare**.
- Larger and smaller listed companies had **different adoption experiences**.
- IFRS requires an **increased amount of judgement.**
- Concerns about **consistency** of application.
- **Audit firms** played a pivotal role.
- Implementation has been **challenging** but **successful**.

(1): *EU Implementation of IFRS and the Fair Value Directive, A report for the European Commission*, ICAEW.

Fair value in IFRS

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Fair Value Definition

- Fair value is 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.[2]

- EU Implementation of IFRSs: the use of fair value[3]

  "[…] the use of fair value accounting under IFRS is much less extensive than is sometimes assumed to be the case, and is in fact very limited overall. In particular, where companies are given an option as to whether to use a cost or a fair value model, they typically choose a cost model."

(2): IFRS 13 *Fair Value Measurement*
(3): *EU Implementation of IFRS and the Fair Value Directive, A report for the European Commission*, ICAEW.

Use of fair value in IFRS

ASSET TYPE	MEASUREMENT AT INITIAL RECOGNITION	SUBSEQUENT MEASUREMENT
IFRS 9 *Financial Instruments*	**Fair value**	**Amortised cost** or **fair value**, depending on the business model.
IAS 16 *Property, Plant and Equipment*	**Cost**, which includes purchase costs + construction costs + costs to bring to the location and condition necessary to be capable of operating in the manner intended by management.	Accounting policy choice: **cost model** or **revaluation model**.
IAS 38 *Intangible Assets*	**Cost**, which includes purchase costs + development costs + costs to bring to the location and condition necessary to be capable of operating as intended by management.	Accounting policy choice: **cost model** or **revaluation model**.
IAS 40 *Investment Property*	**Cost** including transaction costs	Accounting policy choice: **cost model** or **fair value model**.
IAS 41 *Agriculture*	**Fair value** less costs to sell	**Fair value** less costs to sell

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Criticisms of fair value

Criticisms	Our response
Subjectivity of fair values measurements	• Other estimates require a similar process and involve similar uncertainties (for example, measurement of provisions). • Use valuation technique when there are no observable market prices available or when observable market prices do not represent fair value. • Measurements with a higher degree of subjectivity are subject to more disclosure requirements.
Volatility introduced in reported income	• Fair value reflects the underlying economic volatility of the assets and liabilities themselves. • For earnings to be informative to investors, they need to reflect this volatility.
Procyclicality	• Procyclicality is a natural consequence of an economic downturn. Amplified by fair value? From 2004–2006 banks held c. 50% assets not subject to fair value and prudential filters neutralised the effect to Tier 1 capital of some fair value gains and losses.

Criticisms of fair value - *continued*

Criticisms	Our response
Information constraints (for example, few deep and liquid markets)	• The lack of market data or other key information is a global constraint, rather than a regional one. • Even when limited information is available, fair value measurements can still be performed.
Limited valuation expertise	• Commitment to provide educational material to assist in the implementation of fair value principles.
Guidance provided is not detailed enough	• Educational material must benefit all entities (in developed and emerging economies).

> **"Proposals for alternative accounting methods, such as historical cost or simplistic mechanisms to smooth valuation effects on bank balance sheets, reduce the transparency of a financial institution's health by blurring the underlying capital position."(4)**

(4): *Global Financial Stability Report,* International Monetary Fund, October 2008.

Main references

- *How did Financial Reporting Contribute to the Financial Crisis?,* Mary E. Barth and Wayne R. Landsman
- *EU Implementation of IFRS and the Fair Value Directive, A report for the European Commission,* ICAEW
- *Global Financial Stability Report,* International Monetary Fund, October 2008
- *Did Fair Value Accounting Contribute to the Financial Crisis?,* Christian Laux and Christian Leuz
- *Report to the Trustees of the IFRS Foundation,* 22 October 2012

Thank you – Muchas gracias