IFRS Foundation

IFRS Conference

Thursday 29 and Friday 30 May 2014

Marina Bay Sands Hotel, Singapore

Special Interest Session

Investor-focused IFRS update

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IFRS Foundation: Special Interest Sessions

Morning of Thursday 29 May 2014—Marina Bay Sands Hotel in Singapore

Investor-focused IFRS update

To assist the investor and analyst communities understand the effects of new and amended IFRSs to financial reporting, the IFRS Foundation will hold a workshop before the IFRS conference, on the morning of 29 May 2014. This session will also be useful to investor relations personnel who communicate changes in accounting requirements to investors and analysts.
In this session:

- *An IASB member will summarise particular new IFRS principles;*
- *A panel of analysts, investors and preparers will then discuss the effects of the changes on financial analysis and valuation.*

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

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

09:35 ***Panel discussion and Q&A***

Panellists include:

- **Stephen Cooper,** *Member,* **IASB**
- **Andrew Stotz,** *President,* **CFA Society Thailand**

Topics:

Analysing recently implemented IFRS standards and new disclosures to extract investment insights:

- Employee Benefits (IAS 19).
- Consolidated Financial Statements (IFRS 10)
- Joint Arrangements (IFRS 11)
- Disclosure of Interests in Other Entities (IFRS 12)

New Accounting Standards on Revenue Recognition and Leases:

- Examine areas of financial analysis and valuation that investors can anticipate will see changes resulting from the new information when these accounting standards are implemented.

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

12:00 ***Close session***

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International Financial Reporting Standards

Investor-Focused Update

IFRS Conference: Singapore

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IFRS Foundation Conference

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.

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Who we are:

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- IASB:
  - Stephen Cooper, IASB member
- Investor perspectives:
  - Andrew Stotz, CFA, President, CFA Society Thailand

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How will this session work?

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- 2 part session with a Break
  - 1st Part on IFRS that are currently effective
  - 2nd Part on select IFRS that are not yet effective or finalised
- For each topic Steve will discuss:
  - select changes to IFRS effective from 2013 and 2014
  - concepts behind the changes
  - new information available for investors

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How will this session work?

- For each topic Andrew will discuss:
  - benefits of the new information,
  - insights that can be obtained,
  - Impact on financial analysis & valuation, and
  - unresolved issues or questions

Part 1 Highlights: New IFRSs

- Investors seeing changes to company reports in 2013-14
- The following areas of change can lead to restatements that investors will want to understand:
  - **Consolidated Financial Statements** – control and new guidance for investment entities (IFRS 10)
  - **Joint Arrangements** - Removal of the proportionate consolidation accounting method for Joint Ventures (IFRS 11)
  - **Disclosures**
    - for unconsolidated structured entities and disclosures of risks associated with interests in other entities (IFRS 12)
  - **Employee Benefits**—Removal of the corridor method (IAS 19)

Part 2: Forthcoming IFRSs

- Leases
  - Not yet finalised.
  - IFRS and US GAAP more closely converged
  - Recognising operating leases on balance sheet
- Revenue recognition (IFRS 15):
  - Effective 1 January 2017
  - IFRS and US GAAP converged
  - Improving consistency across industries and geographies

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Effective Dates of Standards in 1st Discussion

Change	IFRS	Title	IASB (FY starting)	EU & Singapore (FY starting)
New IFRS	IFRS 10	Consolidated Financial Statements	01.01.2013	01.01.2014
New IFRS	IFRS 11	Joint Arrangements	01.01.2013	01.01.2014
New IFRS	IFRS 12	Disclosures of Interests in Other Entities	01.01.2013	01.01.2014
Amended	IAS 19	Employee Benefits (2011 revision)	01.01.2013	01.01.2013

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IFRS 10
Consolidated Financial Statements

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Why did the IASB issue IFRS 10?

Prior to IFRS 10….

- Inconsistencies in practice because two different sets of consolidation guidance:
  - One focused on control,
  - the other on risks and rewards

What the IASB heard…

- 'Off Balance Sheet Vehicles' and associated risks blind sided investors
- World leaders and investors demanded changes to accounting and disclosure requirements

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IFRS 10: Simplifying Consolidation

- "Control" is the driver behind consolidation
- Does Control exist or not? 3 elements examined to determine whether it exists
    1. Power
    2. Returns
    3. Link between 1 & 2
- Consolidation is possible with less than a majority voting interest in an investment.
- Investment companies are not required to consolidate investees that are controlled.

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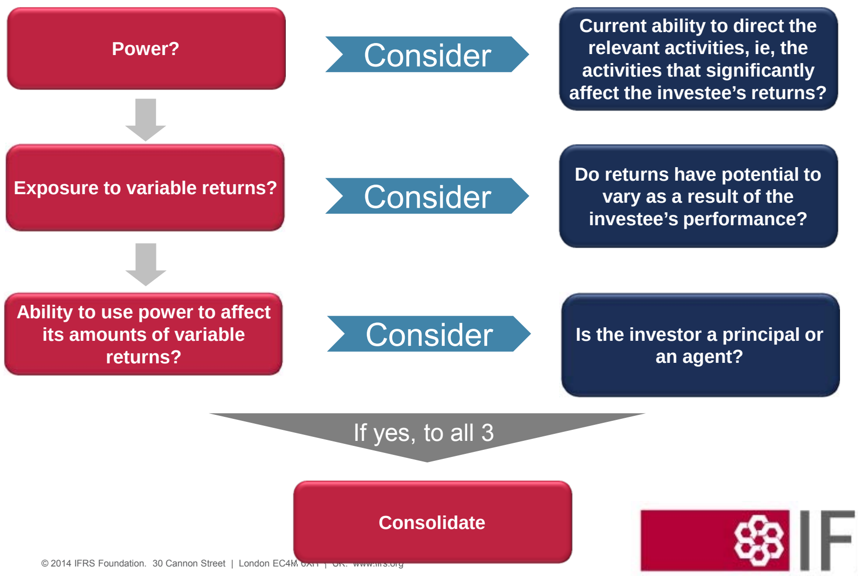
Consolidation Decision Process



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Financial Statement Effects

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Balance Sheet	• Assets, liabilities and equity may increase or decrease depending on consolidation decision and previous accounting method. • Ratios to consider: ROA, Debt/Equity, Book value
Statement of Profit or Loss and OCI	• Income, expenses and other comprehensive income may increase or decrease depending on consolidation decision and previous accounting • Ratios to consider: Interest coverage, Return on sales
Notes to Financial Statements	• Information about the investee balance sheet and risks (eg: leases, employee benefit plans, commitments) • Information related to recurring or non-recurring components of income or expense (eg: significant gains or losses, concentration risks)

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Who and What are affected?

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Banks

Insurance companies

Oil and Gas companies

Pharmaceutical companies

Managed Funds

Activities that are affected

Securitisation transactions

Leasing

Unit-linked contracts

Energy contracts

Private equity funds

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Investor Considerations

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Investor Considerations

What are the benefits and insights provided by the new standard/disclosures?
1. Nature, extent and financial effects of an entity's interests in investees (eg: returns and variability of returns).
2. Nature of the risks associated with subsidiaries and unconsolidated entities (eg: implicit or explicit commitments to fund subsidiaries or unconsolidated entities)
3. Information about non-controlling interests (significant potential voting rights or puts)
4. Understanding of business strategy: (eg: R&D or production facilities previously unconsolidated, but now consolidated)
5. Identification of earnings and dividend flows (eg: are there tax implications or regulatory restrictions on earnings)

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Analysis and Valuation

Profit margins and returns
- Gross margins & profit margins
- Return on Assets
- Return on Equity

Risk
- Financial leverage analysis
- Cross-country comparisons
- Cross-industry comparisons

Valuation
- Enterprise Value models
- Core vs. Non Core view of a firm

IFRS 10 – Practical Observations

- For Investor community, the limited ability to analyse the impact in anticipation of change meant greater reliance on company-specific guidance
- Analyst education required in some cases to ensure any potential one-off effects from transition were not used in forecasts.
- Raising Equity & Debt Investors awareness of valuation implications for certain methodologies

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IFRS 11 *Joint Arrangements*

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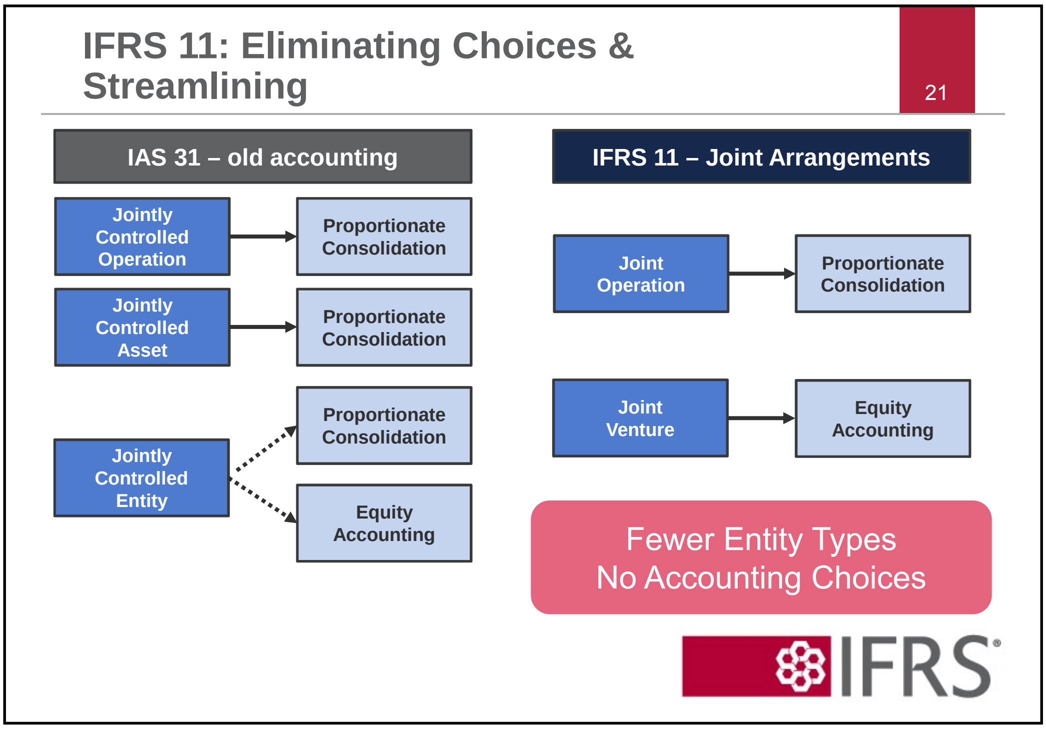
Why did the IASB issue IFRS 11?

Prior to IFRS 11…

- Structure of a joint arrangement dictated the accounting
- This resulted in an accounting option (depending on whether structured through an entity or not)

What the IASB decided…

- Simplify the types of joint arrangements
- Eliminate an accounting choice


IFRS 11: Eliminating Choices & Streamlining
21
IAS 31 – old accounting
Jointly Controlled Operation
Proportionate Consolidation
Jointly Controlled Asset
Proportionate Consolidation
Jointly Controlled Entity
Proportionate Consolidation
Equity Accounting
IFRS 11 – Joint Arrangements
Joint Operation
Proportionate Consolidation
Joint Venture
Equity Accounting
Fewer Entity Types
No Accounting Choices
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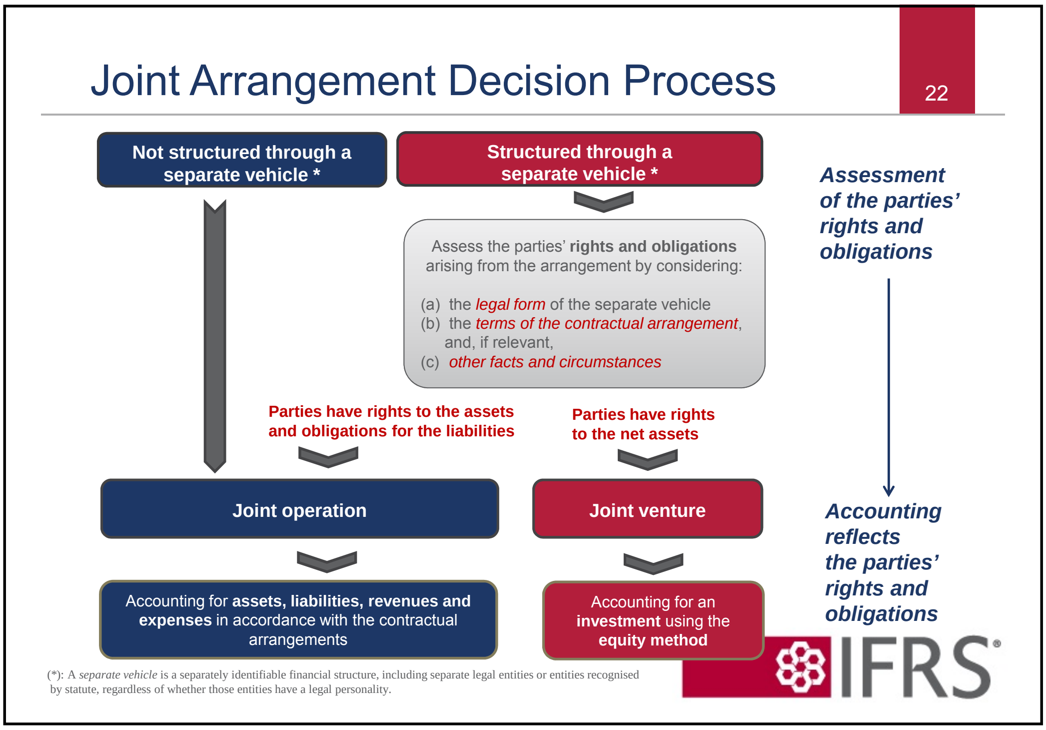
Joint Arrangement Decision Process
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Not structured through a separate vehicle *
Structured through a separate vehicle *
Assess the parties' rights and obligations arising from the arrangement by considering:
(a) the legal form of the separate vehicle
(b) the terms of the contractual arrangement, and, if relevant,
(c) other facts and circumstances
Parties have rights to the assets and obligations for the liabilities
Parties have rights to the net assets
Joint operation
Joint venture
Accounting for assets, liabilities, revenues and expenses in accordance with the contractual arrangements
Accounting for an investment using the equity method
Assessment of the parties' rights and obligations
Accounting reflects the parties' rights and obligations
(*): A separate vehicle is a separately identifiable financial structure, including separate legal entities or entities recognised by statute, regardless of whether those entities have a legal personality.
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Financial Statement Effects

Balance Sheet

- Transition from proportionate consolidation to equity method or transition from equity method to direct recognition will affect gross assets and liabilities.
- Ratios to consider: ROA, Debt/Equity, Book value

Statement of Profit or Loss and OCI

- Transition from proportionate consolidation to equity method or transition from equity method to direct recognition will affect revenues and expenses.
- Ratios to consider: Interest coverage, Return on sales

Notes to Financial Statements

- Information about the investee balance sheet and certain risks (eg: leases, employee benefit plans, commitments)
- Information related to recurring or non-recurring components of income or expense (eg: significant gains or losses, concentration risks)

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Investor Considerations

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Investor Considerations

What are the benefits and insights provided by the new standard/disclosures?
1. The shift in accounting methods may influence how future joint arrangements are structured: Issues to consider are: debt arrangements (recourse to non-recourse), borrowing capacity, and covenants.
2. Disclosures providing information about off-balance sheet activities and the implications for the financial flexibility of the reporting entity, particularly information about commitments to contribute funding.
3. Elimination of accounting choices makes the understanding of off-balance sheet activities more comparable and understandable.
4. Performance measures for management compensation may be adjusted because of the effects on reported ratios and pre-tax income.
5. Summarised financial information will be available for each material JV, subject to some aggregation tests. These disclosures are more detailed and more disaggregated compared to those under IAS 31

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Analysis and Valuation

Profit margins and returns
- Gross margins & profit margins
- Return on Assets
- Return on Equity

Risk
- Financial leverage analysis
- Cross-country comparisons
- Cross-industry comparisons

Valuation
- Enterprise Value models
- Core vs. Non Core view of a firm

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IFRS 11 – Practical Observations

- For Investor community, the limited ability to analyse the impact in anticipation of change meant greater reliance on company-specific guidance
- Some companies produced extensive restatement disclosures as effects on cash flows and net debt were significant.
- Raising Equity & Debt Investors awareness of valuation implications for certain methodologies

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IFRS 12
Disclosure of Interests in Other Entities

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Why did the IASB issue IFRS 12?

Prior to IFRS 12…

- Disclosures in the financial crisis were not sufficient:
  - Little or no information about structured entities
  - No information provided when reputational risk was used as a basis for consolidation, or why

What the IASB decided

- Streamline the disclosure requirements relating to support for IFRS 10 and IFRS 11 into 1 single standard.

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IFRS 12 – Key Messages

- Support for IFRS 10
  - Disclosure requirements for an entity's special relationships with other entities.
  - Address the issues during the financial crisis dealing with the lack of transparency (ie "off-balance sheet" vehicles)
- Support for IFRS 11
  - Disclosure requirements about an entity's interests in Joint Arrangements.
- Disclosure requirements about an entity's interests in subsidiaries and associates, and unconsolidated structured entities.
- Provide information about the profit or losses and cash flows available to the investor.

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IFRS 12 interaction with IFRS 11

- Improving Transparency on Joint Arrangements

Investors get disclosures that help analyse earnings power & cash flows:

JV earnings

JV Cash flows

JV net debt

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Meeting the disclosure objective

Disclosures

- significant judgements and assumptions made
- information about interests in:
  - subsidiaries
  - joint arrangements and associates
  - unconsolidated structured entities
- any additional information that is necessary to meet the disclosure objective

Strike a balance between overburdening financial statements with excessive detail and obscuring information as a result of too much aggregation

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IAS 19R
Employee Benefits

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Why did the IASB amend IAS 19?

Prior to IAS 19R…

- Investors told us the accounting was confusing…
- But they appreciated that pension liabilities can be large and carry uncertainty (in some cases)
- Accounting choices hurt comparability

What the IASB decided

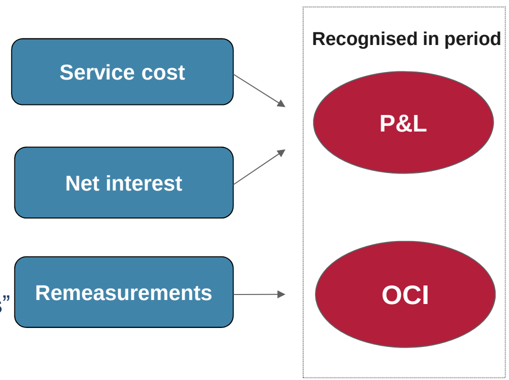
- Amend select accounting requirements in a short period of time

Principal Changes to IAS 19R

- Reduction in choices available for the recognition of actuarial gains and losses:
  - Previously:
    - Immediate recognition through OCI
    - Immediate recognition through P/L
    - Deferred recognition through P/L ('corridor approach')
  - Now:
    - Immediate recognition through OCI
- Remeasurements in other comprehensive income
- Use of the net interest approach in reporting changes in defined benefit plans

IAS-19: Reflecting the economics

- **Simplifying approach**
  - P&L reports operating and financing costs
  - OCI reports the "remeasurements"
- **Recognition of Costs**
  - Earnings "Smoothing" eliminated
- **Making More Sense**
  - The "net interest" approach eliminates the confusing "expected return on plan assets"
- **Disclosures Upgraded**
  - Providing better insight into management's judgements



Financial Statement Effects

Balance Sheet

- Equity may decrease (increase) if a company has unrecognised actuarial losses (gains) at transition.
- Comparability enhanced because actual deficit /surplus in DBP will be reported on balance sheet.
- Ratios to consider: ROA, Debt/Equity, Book value

Statement of Profit or Loss and OCI

- Net profit may be reduced because it will no longer reflect the expectation of higher returns on assets.
- OCI may fluctuate more because all market related assumptions will be reported here.
- Ratios to consider: Interest coverage, Return on sales

Notes to Financial Statements

- Simplifies the reporting of changes in defined benefit plans by introducing the net interest approach
- Information related to average duration of the DBO
- Consider effects on loan covenants or borrowing capacity

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Investor Considerations

Investor Considerations

What are the benefits and insights provided by the new standard/disclosures?
1. Balance sheets will reflect the actual funded status of an entity, which will improve comparability between reporting entities.
2. Statements of comprehensive income will reflect actual economic outcomes – no more smoothing
3. Perception of financial leverage (and hence financial strength) may affect current or prospective borrowing arrangements
4. Expansion of disclosure requirements should provide a better understanding of how to evaluate the financial effect of DBP assets and liabilities on the SCI and SFP.
5. Key disclosures to consider: expected contributions in the next reporting period, maturity profile of DBP, sensitivity analysis of DBO, disaggregation of fair value of plan assets.

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Forthcoming IFRSs

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Leases

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Questions for investors and analysts

1. Do you believe leases create assets and liabilities?
   - Should they be reported on the balance sheet?
2. Do you agree with the lease presentation on the income statement?
3. When considering the package of information in the main statements, together with the disclosures:
   - What is missing?
   - What is included but not useful for your analyses?

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Why a Leases project?

Lessee
- Most lease assets and liabilities are off-balance sheet
- Limited information about operating leases

$1.25 trillion
of off-balance sheet operating lease commitments for SEC registrants*

* Estimate according to the 2005 SEC report on off-balance sheet activities

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Current adjustments to capitalise leases

Multiplying current lease expense *(see graph)*
- Doesn't take into account differences in lease terms or interest rates

Discounted projected lease payments
- Assumptions based on limited information in note disclosures

Assumption: $200 million annual lease payment

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How the proposals improve financial reporting

Existing accounting	How the proposals address those	How the proposals improve financial reporting
Most lease assets and liabilities are off-balance sheet →	Recognition of lease assets and liabilities for all leases of more than 12 months →	Greater transparency about lessee's leverage, assets used in operations and cash flows
Insufficient information provided about operating leases →	Enhanced disclosures →	

Lessee accounting model

	Balance sheet	Income statement	Cash flow statement
Most equipment/ vehicle leases	Right-of-use asset[1] Lease liability[1]	Amortisation expense Interest expense	Cash paid for principal and interest
Most real estate leases	Right-of-use asset[1] Lease liability[1]	Single lease expense[2]	Cash paid for lease payments

[1] Excludes variable lease payments linked to sales or use and most payments in renewal periods—decision taken to reduce cost and complexity.

[2] Interest on lease liability available in note disclosures.

Lessee disclosures

Qualitative

- General description of leases
- Terms of:
  - variable lease payments
  - extension/termination options
  - residual value guarantees
- Restrictions and covenants
- Information about leases not yet commenced

Quantitative

- Maturity analysis of undiscounted cash flows for each of first 5 years plus total thereafter
- Reconciliation of lease liability
- Expense relating to variable lease payments
- Reconciliation of right-of-use asset by asset class (IASB only)

Judgments & Risks

- Nature and extent of risks arising from leases
- Significant assumptions and judgments

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Examples

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Balance sheet impact — Retailer

No change to Retailer's income statement or cash flow statement.

Disclosures - Retailer

- Qualitative information about leases, including terms of variable lease payments and extension options
- Quantitative information about amount of variable lease payments linked to sales
- Maturity analysis of undiscounted lease payments for each of first five years and thereafter
- Rollforward of right-of-use asset (IASB only) and lease liability

Balance sheet impact — Airlines 1 and 2

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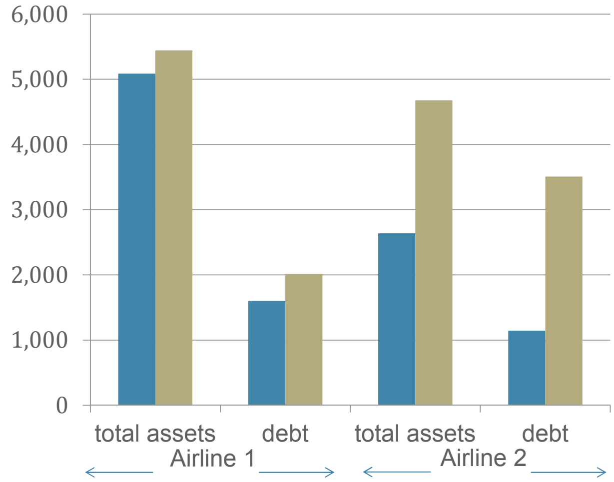

Assumptions:
- Fleet of 167 aircraft
- Owned/Leased split (in %)
  - A1: 70/30
  - A2: 30/70
- Discount rate: 8%

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Income statement impact — Airlines 1 and 2

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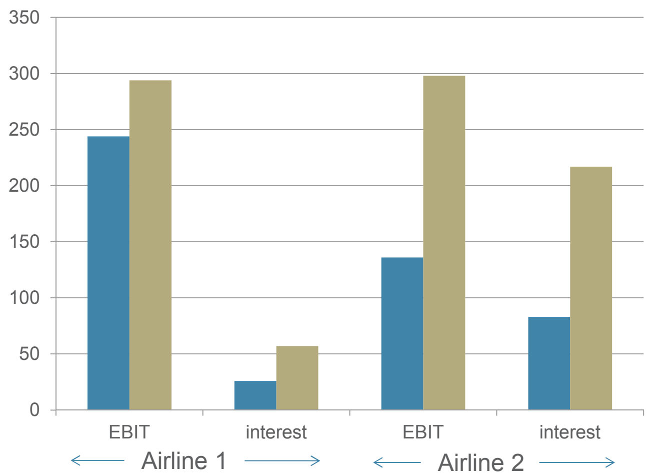

Assumptions:
- Discount rate: 8%
- Average lease term:
  - A1: 8 years
  - A2: 11 years
- Aircraft leases in 2nd half of lease term
  - A1: 90%
  - A2: 75%

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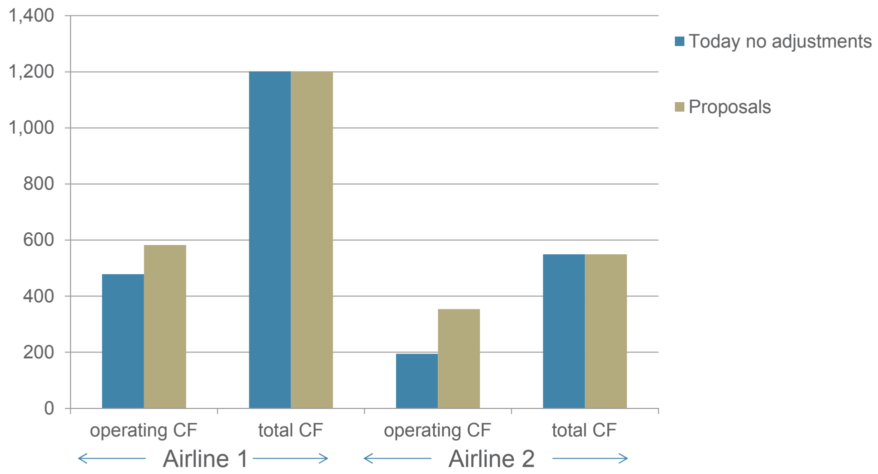
Cash flow statement impact — Airlines 1 and 2



Disclosures—Airlines 1 and 2

- Qualitative information about leases
- Maturity analysis of undiscounted lease payments for each of first five years and thereafter
- Roll-forwards of right-of-use asset by asset class (IASB only)
- Roll-forwards of lease liabilities related to aircraft leases and real estate leases

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Investor Considerations

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Investor Considerations

What are the benefits and insights provided by the new proposals?
1. Assets -- Capitalisation of existing operating leases by lessees will increase asset balances, resulting in lower asset turnover and return on asset ratios compared to operating lease accounting.
2. Liabilities -- For both real estate and equipment leases, reported leverage by lessees will more faithfully reflect economic leverage. At transition, the increase in reported debt will cause working capital ratios to decrease, while debt to equity and other leverage ratios will increase.
3. Income and expense -- The effects on profitability metrics will vary – both at transition and over time.
4. Cash flows -- Capitalisation of operating leases by lessees will cause operating and financing cash flows to change –the change will depend on the nature, classification and size of each lessee's portfolio and whether the portfolio is increasing or decreasing.
5. Will make companies that primarily lease assets more comparable to companies that purchase assets.

Next Steps

- Exposure Draft **May 2013**
- Comment Period Closed **Sep 2013**
- IASB & FASB Redeliberations **Ongoing as of Q2-14**
- New Standard Issued **TBD**
- New Standard Effective **TBD**

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Revenue Recognition

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Revenue recognition

Core Principle

Recognise revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services

When?	The company satisfies a performance obligation by transferring a good or service to customer
How much?	Amount of the transaction price allocated to the transfer of goods or services (ie satisfied performance obligation)

Disclosure requirements

Objective: To enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers

Qualitative information about

- Estimates and judgements used
- Performance obligations

- Disaggregation of revenue

  required for interim reporting
- Contract assets and contract liabilities (eg unbilled A/R and deferred revenue
- Assets recognised from the costs to obtain or fulfil a contract
- Remaining performance obligations (ie Information about long-term contracts)

Transition, effective date and early application

- **Effective date:** annual reporting periods beginning on or after 1 January 2017
- Early application permitted (IFRS)
- **Transition methods**
  - Retrospective transition method (with optional practical expedients); or
  - Alternative transition method (ie cumulative catch-up method)

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Investor Considerations

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Investor Considerations

What are the benefits and insights provided by the new standard/disclosures?
1. Removing inconsistencies and weaknesses in existing revenue recognition standards/practices
2. Providing a more robust framework for analysing revenue – particularly transactions involving multiple elements and delivery of goods or services over time.
3. Simplifying the number of accounting standards an investor must understand across industries and sectors.
4. Improving comparability of revenue across companies and geographies.
5. Establishing a common set of disclosures to permit investors to ask comparative questions and to develop expectations of changes over time.

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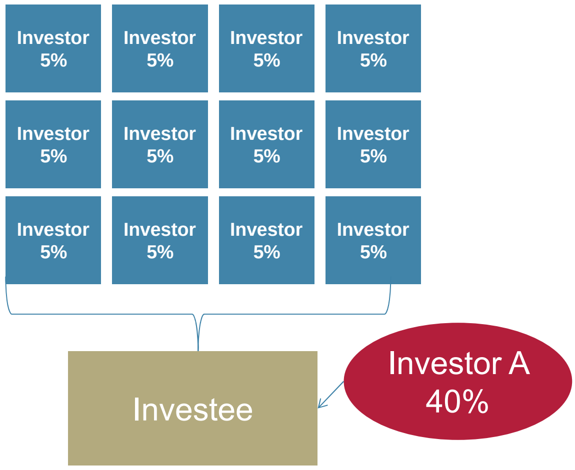
Reference:
Illustrative Example of IFRS 10

Example 2: rights

- The Reporting Entity, “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 shareholder agreement.



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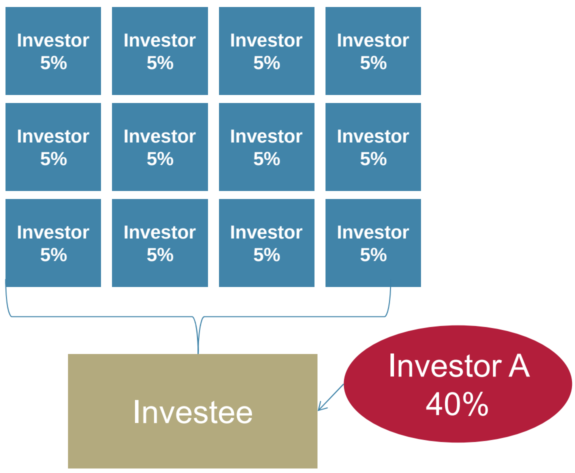
Example 2: *Analysis*

- The Reporting Entity, “Investor A”, is able to direct the relevant activities of Investee B through the combination of the shareholders’ agreement and the 40% voting interest.
- **Investor A concludes it controls Investee B, and should consolidate.**
- Investor A’s shareholding prevents other parties from changing the contractual relationship it has to direct the relevant activities of Investee B, because such a change requires a two-thirds majority.



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Recap of IFRS 10-11-12 Package

Investors will see

IFRS	Key Considerations	Impact on Restated Figures
IFRS 10	New Definition of Control	De-consolidation of certain assets where control is not exercised
IFRS 11	Proportionate Consolidation not permitted for JVs	De-consolidation of financial entities previously consolidated

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Reference: IFRS 11 Background

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Who is affected?

JV deals by industry (1990–2010)		
Industry	**JV deals**	**Relative relevance**
Business services	17,610	20.45%
Software	6,718	7.80%
Wholesale trade: durable goods	5,840	6.78%
Investment and commodity firms	4,980	5.78%
Electronic	3,321	3.86%
Telecommunications	2,545	2.95%
Wholesale trade: non-durable goods	2,300	2.67%
Mining	2,297	2.67%
Oil and gas	2,166	2.51%
Real estate	1,781	2.07%
Others	36,577	42.46%
Total number of JV deals	**86,135**	**100.00%**

Data source: Thomson Financial SDC Platinum Alliances/Joint Ventures database

Who is affected?

Country	% companies with Joint Ventures using proportionate consolidation
France	80.00%
Germany	33.33%
Italy	33.33%
Netherlands	56.25%
Spain	86.66%
Sweden	50.00%
Switzerland	50.00%
United Kingdom	18.75%

Source: von Keitz, I. (2006) The Application of IFRS: Choices in Practice. KPMG

Who is affected?

Industry	% companies with Joint Ventures using proportionate consolidation
Consumer Markets	46.66%
Financial Services	48.65%
Industrial Markets	53.97%
Information, Communications and Entertainment	47.37%
Infrastructure and Healthcare	40.00%

Source: von Keitz, I. (2006) The Application of IFRS: Choices in Practice. KPMG

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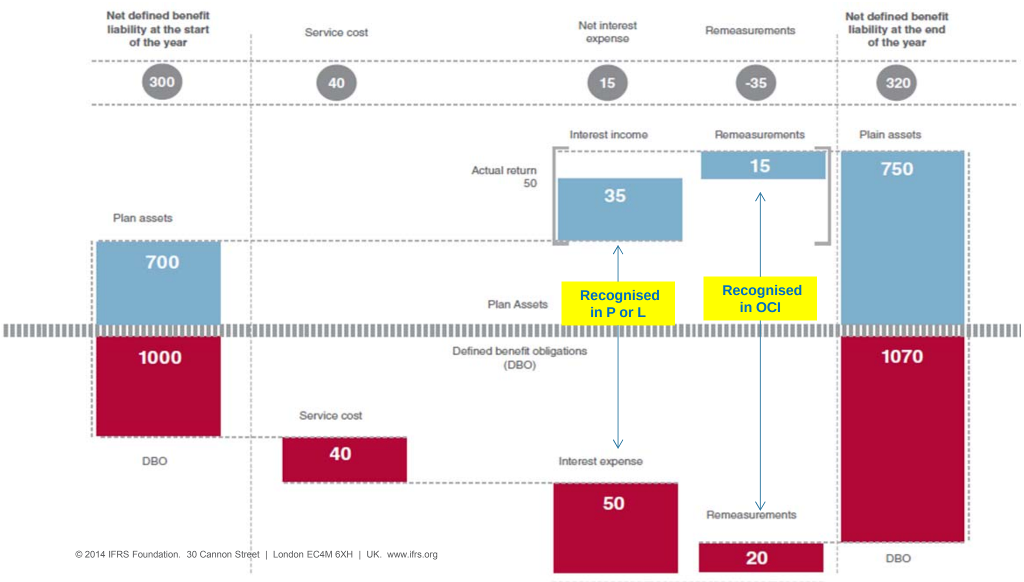
Reference: IAS 19R background

Example of IAS 19R



Who is affected by the change? NF6

- Only companies who do not immediately recognise actuarial gains and losses through OCI

Country	Index	Immediate through OCI	Corridor	Immediate through P&L
UK	FTSE 100	89%	8%	3%
Germany	DAX 30	67%	33%	0%
Germany	Non-DAX 30	25%	64%	11%
France	CAC 40	55%	45%	0%
France	Non-CAC 40	46%	48%	5%

Source: Street, D.L. and Glaum, M. (2010), *Methods for recognition of actuarial gains and losses under IAS 19,* ACCA.

Slide 74

NF6 Given that IAS 19R produces changes affecting large caps in Europe more than in many of the Asian countries using IFRS, this is a slide that can be deleted (in the interest of time)
Nieto Fred, 02/05/2014

What is the size of the impact?

Country	Index	Mean unrecognised actuarial gains and losses (€ mm)	Unrecognised actuarial gains and losses divided by equity
UK	FTSE 100	(2,074.50)	(0.02)
Germany	DAX 30	(410.45)	(0.02)
Germany	Non-DAX 30	(4.20)	(0.00)
France	CAC 40	(242.60)	(0.01)
France	Non-CAC 40	(53.05)	(0.02)

Source: Street, D.L. and Glaum, M. (2010), *Methods for recognition of actuarial gains and losses under IAS 19,* ACCA.

IFRS standards that are subject for today's seminar

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New IFRS standards

IFRS 10-12 package

- **IFRS 10:** Consolidated financial statements
- **IFRS 11:** Joint arrangements, the removal of proportionate consolidation of JVs
- **IFRS 12:** Disclosures

IAS 19

- **IAS 19:** Employee benefits, removal of the corridor method

Upcoming IFRS standards

- **IFRS 15:** Revenue recognition, improving consistency across sectors and countries
- **Leases:** Recognizing operating leases on the balance sheet

Sources: A.Stotz Investment Research, IFRS Foundation

Description of universe selection and methodology for qualitative study

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Universe selection

- Selected the ten largest companies for each sector by market capitalization
- Checked the distribution of the companies across countries and added a few large-cap companies for the countries that had less than two companies
- Ended up with 100 companies in our analysis

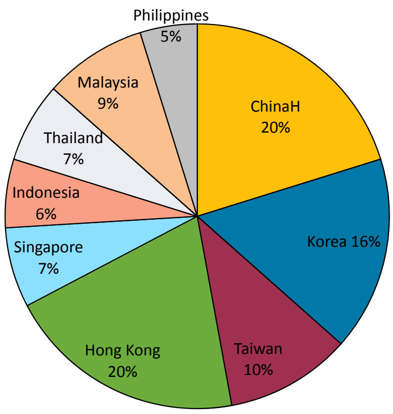
Data collection

- Gathered annual reports for FY2012 and FY2013 for each company
- Collected data from the reports regarding standards for consolidation approach, JV accounting, leasing accounting, and employee benefits
- For every item we asked the following questions: 1) Is the standard relevant for the company?; 2) What type/method does the company use?; and 3) What standard do they follow for reporting purposes?

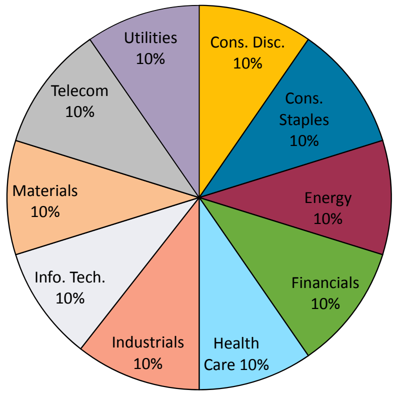
Sources: A.Stotz Investment Research, IFRS Foundation

Investigated 100 Asian companies for 2012 and 2013

Regional breakdown of investigated universe



Sector breakdown of investigated universe



Sources: A.Stotz Investment Research, Thomson Reuters

The majority of the investigated companies has already implemented the standards

- **IFRS 10:** In 2013 73% of the companies disclosed that they had changed reporting standards. Out of those companies 70% had implemented IFRS 10 (*or local equivalent e.g. KFRS-1110, PFRS 10, MFRS 10 etc*)
- **IFRS 11:** For 75 companies, JV accounting was relevant in 2013, and 96% of the companies used the equity method vs 91% in 2012. Out of those companies 80% had implemented IFRS 11 (*or local equivalent*)
- **IAS 19:** In 2012, 58% of the companies used some form of IAS 19, this number had increased to 68% for 2013.
- **Leases:** Regarding leases there weren't much changes between the two years, but noticeable for the forthcoming standards is that about 50% of the companies only reported operating leases, while about 40% reported financial leases, and the rest of the companies reported both types
- **In addition:** 97% used straight-line approach to depreciate company assets

Sources: A.Stotz Investment Research, Thomson Reuters

The IFRS 10-12 package

IMPACT ON THE INCOME STATEMENT

DKK million	2013 Reported	2013 Restated
Net revenue	**66,552**	**64,350**
Cost of sales	-33,622	-32,423
Gross profit	**32,930**	**31,927**
Sales and distribution expenses	-18,717	-18,181
Administrative expenses	-4,502	-4,415
Other operating activities, net	17	22
Share of profit after tax, associates	116	370
Operating profit before special items	**9,844**	**9,723**
Special items, net	-466	-435
Financial income	721	717
Financial expenses	-2,254	-2,223
Profit before tax	**7,845**	**7,782**
Corporation tax	-1,894	-1,833
Consolidated profit	**5,951**	**5,949**

- ★ Here is Carlsberg's 2013 income statement as reported and restated to comply with the IFRS standards
- ★ Gross profit, SG&A and others will decrease while the equity income will increase
- ★ IFRS 10-12 can make equity income disproportionately big for companies that operates mainly via JVs. It will then also affect for example ROA, since with equity consolidation JVs will only be reflected as net assets
- ★ A heavier workload for the analyst to find the margins for the whole group, while getting more info to do Sum-of-the-parts (SOTP) valuation

The IFRS 10-12 package

Operating margin (%)		
Western Europe	13.6%	13.9%
Eastern Europe	23.3%	23.3%
Asia	19.5%	20.8%
Not allocated	-	-
Beverages, total	15.0%	15.3%
Carlsberg Group, total	**14.8%**	**15.1%**

- ★ For Carlsberg we can see that their operating margin slightly changes, which makes the year-on-year comparison slightly diluted
- ★ **For companies with many JVs:**
- ★ EBITDA could change vastly, due to these standards
- ★ Impact multiples such as EV/EBITDA multiple. EV because of getting only net assets and no debt from proportionate consolidation
- ★ DCF valuation could be impacted due to EBIT change and reducing of depreciation from deconsolidation
- ★ Hard to compare with historic statements. For example revenue and hence sales valuation multiples can change significantly

IAS 19R

★ Before IAS 19R if these gains and losses reached a sufficient magnitude with respect to the PBO (pension liabilities) and market value of plan assets, they were gradually amortized and recognized as part of pension expense (the so-called "corridor" method)

★ With IAS 19R immediate recognition of actuarial gains and losses in other comprehensive income

★ According to the IASB, the discount rate should be determined by reference to market yields on high quality corporate bonds at the end of the reporting period, and if there is no deep market for these bonds, the firm should use the market yields on government bonds (IASB, 2011, paragraph 78).

★ IAS 19R may cause additional volatility to the company's financial positions, due to the immediate recognition

★ More disclosures especially when it comes to sensitivity in assumption changes is good, but it will leave the analysts to determine whether the management or themselves are most competent to do this estimation

★ However, it will still be based on forecasting. Since no one can foresee the future this still opens up for risk due to erroneous estimates, and therefore volatility in the financial statements

★ In my experience most analysts do not regard this type of item in their valuation

Sources: A.Stotz Investment Research, IFRS Foundation, Thomson Reuters

An academic study comparing TFAS 18 and IAS 19R

Wen-hsin Hsu et al (2013) investigated Taiwanese companies. The estimation of pension asset (liability) value is similar between Taiwan accounting standards (i.e., TFAS 18) and international accounting standards (IAS 19); however, fair value is only disclosed in the financial statements under TFAS 18, but is required to be recognized in the balance sheet under IAS 19. Three main assumptions include (1) discount rate, (2) future salary growth rate, and (3) Expected rate of return on plan assets.

Table 1. Pension assumptions, PBO and the value of pension assets.

Item		Definition
Discount rate	↑	Decrease in PBO
	↓	Increase in PBO
Salary growth rate	↑	Increase in PBO
	↓	Decrease in PBO
ERR on plan assets	↑	Increase in fair value of Pension assets
	↓	Decrease in fair value of Pension assets

★ Using two key inputs for pension pricing model, this study finds that companies are inclined to increase (decrease) the value of pension assets (liabilities) by rising (lowering) the assumed expected rate of asset returns (expected salary growth)

★ The manipulation is more pronounced for firms with high distress risk and complex ownership structure

★ Prior studies find that once firms are required to recognize the fair value (i.e., adopting IAS 19) as opposed to disclose the information (i.e., TFAS 18), firms have higher incentives to manipulate the model inputs

Sources: A.Stotz Investment Research, Thomson Reuters, Wen-hsin Hsu et al (2013)

Operating leases

Re-cap

"Leases: Regarding leases there weren't much changes between the two years, but noticeable for the forthcoming standards is that about 50% of the companies only reported operating leases, while about 40% reported financial leases, and the rest of the companies reported both types"

"Suggestion for new standard: Recognition of lease assets and liabilities for all leases of more than 12 months and enhanced disclosure"

- ★ Can have large impact on balance sheet, total assets and debt
- ★ Can have large impact on operating CF, however total CF stay unaffected
- ★ Operating leases cause rental cost and is included in EBIT, while for financial lease assets gets charged in P&L through depreciation and interest expense. Hence it will affect DCF valuation and EV/EBITDA
- ★ Industries where we are likely to see the largest effects: Airlines, retailers, shipping companies, hotel industry (other entities that rely on leasing as a financing tool for large items)

Sources: A.Stotz Investment Research, IFRS Foundation, Thomson Reuters

Improved reporting standards and analyst forecast accuracy – a literature review

- Many studies have been done during the years that shows a positive relationship between improved disclosure and forecast accuracy, when the new reporting standards is significantly improved
- However for countries that for example have gone from reporting standards that have already been similar to IFRS and then implemented IFRS it is hard to find such a significant positive relationship
- Studies have found that cross-country comparison and multiple-based valuation is improved by harmonizing accounting standards among countries

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Are analysts' EPS forecasts accurate?

- Started with 16,500 stocks in Asia ex-Japan that were listed at some point between year-end 2001 to 2013
- Removed 2,500 China A-shares companies, 5,100 companies that never had analyst forecasts, and 500 companies that shifted fiscal years. After that, 8,400 companies remained
- Each year, re-evaluated and removed companies for that year only if they did not have a full 12 months of forecasts or forecasts ended up being more than 500% different from the actual result or the company had less than three analysts publishing forecasts
- What remained was on average 750 stocks per year that, for any year, had data for forecasted EPS and three or more analyst forecasts

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Methodology

- Identified the month in which most companies in Asia reported their annual results, e.g. in Thailand, the end of February, two months after the December closing date; in Korea, the end of March
- Collected the time series of each month's average analyst forecasted EPS starting from 11 months before the result date, e.g. for Thailand, from the prior year's March (forward-11 months) to February (result date)
- Calculated the percentage difference between the forecasted and actual EPS, regardless of over/underestimation, from forward-11 months to the result date
- Repeated the steps above from FY2001 to FY2013
- Investigated both over/underestimated earnings forecasts, and absolute deviation

The average analysts downgraded by half through the year

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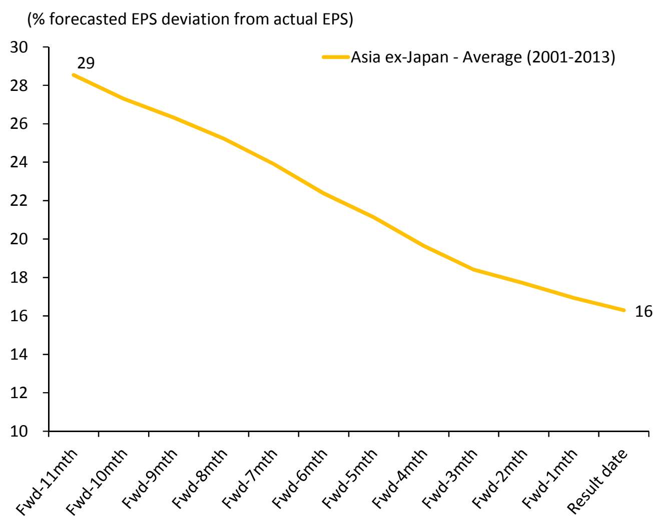

- ★ Each month, we averaged the forecasted EPS absolute deviation during 2001-2013 from forward-11 months to the result date
- ★ Analysts continuously adjusted their forecasts until the result date
- ★ In Asia, analysts started the year by being 29% off with their EPS estimates, their estimates move towards actual results
- ★ Even though analysts' become more accurate closer to the result date, they are still 16% amiss with their predictions at that date
- ★ On average, throughout a year, analysts' EPS forecasts are inaccurate by about 22%

Sources: A.Stotz Investment Research, Thomson Reuters

Analysts in Asia are overly optimistic and fail to foresee declines

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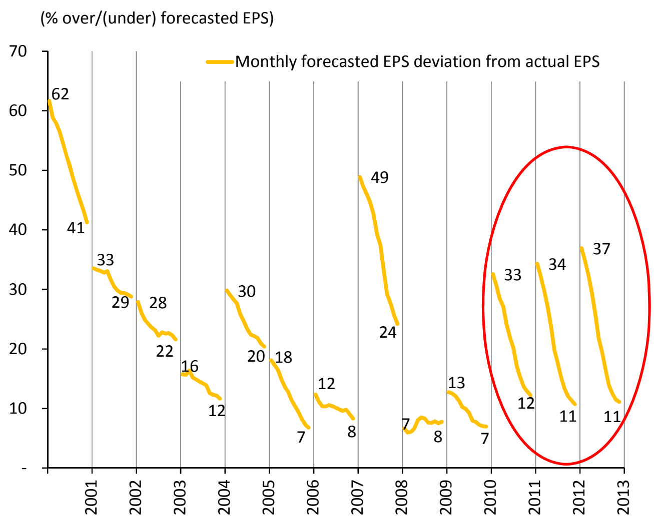

- ★ We chart the time series of over/under forecasted EPS, starting from forward-11 months to the result date for every year, FY2001-FY2013
- ★ In 12 out of 13 years, analysts started with expectations too high and adjusted them down
- ★ In the crisis year 2008, the big drop in Asia corporate earnings surprised analysts, who still started the year at 49% above actual earnings
- ★ For the past three years, analysts' have, on average, cut their EPS forecast by two thirds by the time they have reached the result date
- ★ Conclusion: In nearly every year, analysts started with high estimates, failed to predict downturns, and were always overly optimistic

Sources: A.Stotz Investment Research, Thomson Reuters

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How can analysts and accountants come together?

- Analysts in general are relatively slow and sometimes reluctant to changes
- More disclosures and more information are always appreciated, since it leaves the analyst with more information and options to enhance their valuation
- Harmonizing accounting standards across sectors and countries makes the analysts' job easier
- Changing accounting standards that makes it harder to compare changes over time, retrieving data, feeding data into valuation models, should be done with great caution