SIMPLY CLEVER

ŠKODA

VALUATION IN ACCOUNTING: TRUE AND FAIR (or far) VIEW?

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Scope of the Presentation

- IASB (who they are, what they do)
- IFRS Standards
- Valuation Bases
- Special Areas of Interest:
  - impairment
  - valuation problems
  - operating leases treatment (double-reporting)

International Accounting Standards Board

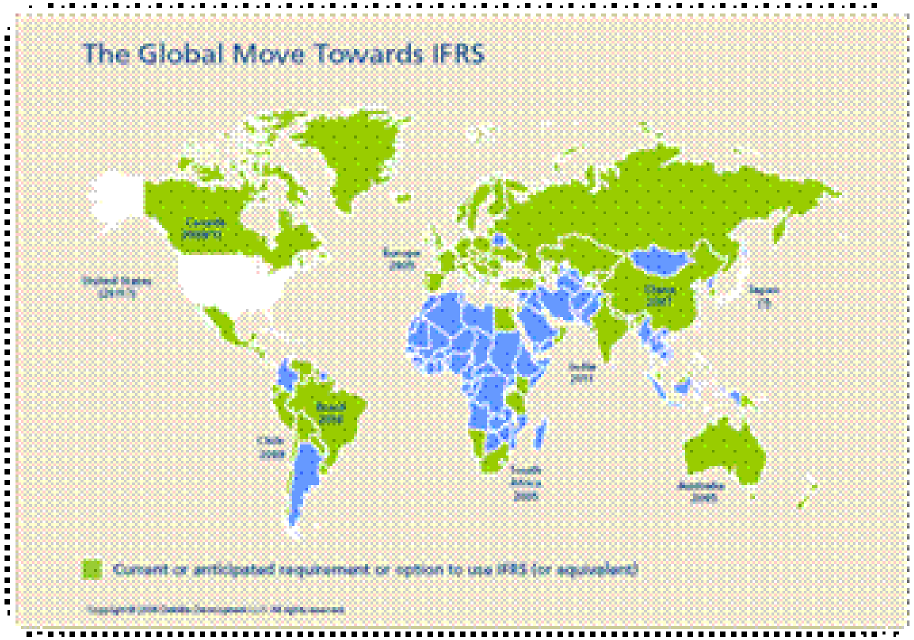
- IASB formed in 2001 – successor to International Accounting Standards Committee (IASC)
  - IASC established in 1973
- IASB adopted all existing IASC standards
  - International Accounting Standards (IAS)
  - Interpretations (SIC)

IASB Objectives

- to develop, in the public interest, a single set of high quality, understandable and enforceable accounting standards that require high quality, transparent, and comparable information in financial statements and other financial reporting to help participants in the various capital markets of the world and other users of the information to make economic decisions
- to promote use and rigorous application of those standards

Current IFRSs

- 28 IAS / 16 IFRS (+ IFRS/SME)
- 11 SIC/ 22 IFRIC (of which three withdrawn)
- 120 countries require or permit IFRS for public companies
  - listed companies in EU adopted IFRS from 2005 for consolidated financial statements and Australia incorporated IFRS in its GAAP from 2005
  - Brazil (2010), Canada (2011), Republic of Korea (2011), Argentina, Mexico and Nigeria (2012)
  - Japan permits use of IFRS for international companies from 2010
- US and China committed to convergence agenda
  - will US adopt IFRS? If so, when?



IFRS in Europe

- EU Law
  - for financial years starting on or after 1 January 2005, companies with debt or equity securities public traded in the EU must prepare their consolidated financial statement in compliance with IFRSs
  - before being legally enforceable, IFRS must go through the EUs endorsement mechanism
    - as adopted for use in the EU

IFRS and US Reporting

- SEC requires foreign registrants to file using
  - US GAAP, or
  - domestic GAAP with a reconciliation to US GAAP (20-F)
- for filings on or after 4 March 2008 SEC abolished reconciliation requirements for foreign issuers that file financial statements using IFRSs published by the IASB
- SEC has been considering whether to permit or require US domestic registrants to adopt IFRSs
  - November 2008 – proposed „Roadmap“
  - February 2010 – Commission Statement in Support of Convergence and Global Accounting Standards

Qualitative Characteristics of Useful Financial Information

- relevant and faithfully represent what it purports to represent
  - relevance refers to is, financial information‘s capability of making a difference in the decisions made by users
  - materiality is presented as an entity-specific aspect of relevance, questioning whether omitting financial information or misstating it could influence decisions that users make
  - faithful representation is defined by reference to three characteristics financial information should try to maximise: to be complete, neutral and free from error
- comparability, verifiability, timeliness and understandability are qualitative characteristics that enhance the usefulness of information that is relevant and faithfully represented

Measurement

- process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the financial statements, involving the selection of the particular basis of measurement
- measurement bases:
  - historical cost
    - assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in Exchange for the obligation, or in some circumstances (e.g. income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business
  - current cost
    - assets are carried at the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently
  - realisable (settlement) value
    - assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal. Liabilities are carried at their settlement values; that is, the undiscounted amounts of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business
  - present value
    - assets are carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business. Liabilities are carried at the present discounted value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business

Fair Value Measurement

- 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
- for computation of fair value should be taken into account e.g. these characteristics:
  - the condition and location of the asset
  - restrictions on the sale or use of such asset
- in case that asset is acquired (or liability assumed) in an Exchange transaction for such asset or liability, transaction price is the price paid to acquire the asset or received to assume the liability – an entry price. However, fair value is the price that would be received to sell the asset or paid to transfer the liability – an exit value. But, in many cases the transaction price would equal the fair value (e.g. on the transaction date the transaction to buy an asset takes place in the market in which the asset would be sold)
- fair value recognition levels
  - level 1 – quoted prices (market value)
  - level 2 – observable inputs (valuation model)
  - level 3 – unobservable inputs (company management's best assumption)
    - Enron, World.Com, Parmalat?????

Special Areas of Interest

- Special Areas of Interest:
  - IAS 16 – Property, Plant and Equipment / IAS 36 – Impairment of Assets
    - how to quantify an impairment for unique assets
  - IFRS 16 – Leases
    - a new treatment for operating leases
  - IFRS 3 – Business Combinations / IAS 38 – Intangible Assets
    - goodwill recognition, brands recognition
      - to amortize or not to amortize?
  - IFRS 9 – Financial Instruments
    - valuation issues
  - IAS 41 – Biological Assets
    - valuation issues

Impairment of Unique Assets (IAS 16 / IAS 36)

- quantification of residual value
- selection of depreciation/amortization method + useful life period
- quantification of recoverable amount:
  - fair value approach vs value in use
    - discounting factor

Operating Leases 2018+ (IFRS 16)

- lessees do not differ between finance and operating leases from 2018
- lessors do report operating leases though
- double reporting issue
  - lessee vs lessor (what if consolidated group members, what if 3rd parties)

Specific Intangibles Valuation (IFRS 3 / IAS 38)

- recognition of goodwill
  - quantification issues (market value quantification)
  - amortize or not to amortize?
- recognition of specific intangible assets
  - value of brand
  - can I report my own brand on my balance sheet?
  - how to amortize brand?

Valuation of Financial Instruments (IFRS 9)

- corporate (not financial institution) POV...
- equity method vs fair value approach
  - reliability of fair value measurement (illiquid, non-transparent capital markets)
- discounting of receivables and liabilities vs nominal values
- derivative issues + hedge accounting
  - could an average accountant compute a fair value of a derivative instruments?
  - hedge effectiveness:
    - loan vs rental contract in foreign currency
    - hedging of an exporting company
    - loans with IRS
- cryptocurrencies challenge

Valuation of Biological Assets (IAS 41)

- first standard fully applying fair value approach (FVTPL)
- average farmer as a professional valuer
- valuation of a breeding bull, salmon, manure, etc.

Alternative Models (IAS 16 / IAS 38 / IAS 40)

- problems with data comparability
- intangible assets + property, plant and equipment
  - cost model
  - alt: fair value hybrid model (increases to OCI, decreases as losses)
- investment properties
  - fair value (FVTPL) model
  - alt: cost model + info about fair value

THANKS FOR YOUR ATTENTION!

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