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Reference: Request for Information – Post Implementarion Review IFRS 13 – Fair

The Comitê de Pronunciamentos Contábeis - CPC (Brazilian Accounting Pronouncements Committee)[1] welcomes the opportunity to respond to the Request for the Post Implementation Review of IFRS 13.

We are a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidance for Brazilian companies.

We agree with the proposed changes and inform that we do not expect any impacts in the Brazilian jurisdiction.

If you have any questions about our comments, please do not hesitate to contact us at operacoes@cpc.org.br.

Yours sincerely,

Silvio Takahashi
Chair of International Affairs
Comitê de Pronunciamentos Contábeis (CPC)

[1]The Brazilian Accounting Standards Board (CPC) is a standard-setting body engaged in the study, development and issuance of accounting standards, interpretations and guidances for Brazilian companies. Our members are nominated by the following entities: ABRASCA (Brazilian Listed Companies Association), APIMEC (National Association of Capital Market Investment Professionals and Analysts), BMFBOVESPA (Brazilian Stock Exchange and Mercantile & Future Exchange), CFC (Federal Accounting Council), FIPECAFI (Financial and Accounting Research Institute Foundation) and IBRACON (Brazilian Institute of Independent Auditors).

1. Methodological Approach

Aiming to provide a better contribution from Brazilian Accounting Standards Board (*Comitê de Pronunciamentos Contábeis*) to the IFRS 13 - Post Implementation Review (PiR), we shared the methodological approach employed to develop our comment letter in three stages, as mentioned below:

Stage 1 – Literature review: In this stage we reviewed the academic literature related to the IFRS 13 – Fair value, looking for the implication of measurement criteria and its potential consequences for investors, lenders / creditors as well as another kind of stakeholders.

Stage 2 – In this section were segregated the questions presented in the IASB's request for information to the PIR – IFRS 13, according to the interest groups. Preparers of Financial Statements, for instance, were supposed to present their comments about the IFRS 13 costs and implementation issues of the IFRS 13 relevance as well as external evaluators were invited to provide their considerations about the questions related to their practical field.

We understand that this methodological choice helped us to address the questions according to the groups' expertise, consequently, improving the quality and reliability of our answers.

At the end of our request information, we have obtained 11 answers; being 9 from Brazilian public companies and 2 from experts in valuation.

Stage 3 – We invited financial analysts to present their concerns about the IFRS 13 relevance, reliability, and other concerns considered matter under their judgment related to the IFRS 13 disclosure and measurement.

To achieve our purpose in this stage, we sent a formal query to the association of the analysts and professionals that work with investments in capital markets - APIMEC (Associação dos Analistas e Profissionais de Investimento do Mercado de Capitais).

2. Stage 1 – Literature Review

There are many pieces of evidence that support the relevance of fair value hierarchy in financial instruments disclosure (IFRS and USGAAP literature). The following papers were identified in our literature review.

We are showing in this section the abstracts from 7 academic papers that considered Fair Value in these research development, being 5 in the FAS 157 context that is the correlate of IFRS 13 in the US-GAAP, and 2 about fair value under IFRS setting.

1) Song, C. J., Thomas, W. B., and H. Yi. 2010. Value Relevance of FAS 157 Fair Value Hierarchy Information and the Impact of Corporate Governance Mechanisms. The Accounting Review. 85 (4): 1375–1410.

   <u>Abstract:</u> Statement of Financial Accounting Standards No. 157 (FAS 157), Fair Value Measurements, prioritizes the source of information used in fair value measurements into three levels: (1) Level 1 (observable inputs from quoted prices in active markets), (2) Level 2 (indirectly observable inputs from quoted prices of comparable items in active markets, identical items in inactive markets, or other market-related information), and (3) Level 3 (unobservable, firm-generated inputs). Using quarterly reports of banking firms in 2008, we find that the value relevance of Level 1 and Level 2 fair values is greater than the value relevance of Level 3 fair values. In addition, we find evidence that the value relevance of fair values (especially Level 3 fair values) is greater for firms with strong corporate governance. Overall, our results support the relevance of fair value measurements under FAS 157, but weaker corporate governance mechanisms may reduce the relevance of these measures.

2) Tama-Sweet, I.; Zhang, L. 2015. The Value Relevance of Fair Value Financial Assets During and After the 2008 Financial Crisis: Evidence from the Banking Industry. Journal of Finance and Bank Management. 3 (1): 11-24.

   <u>Abstract:</u> Statement of Financial Accounting Standard 157 defines a hierarchy of three levels for reporting the fair of financial assets. In this paper we examine value relevance of the three levels of fair value assets and of non fair value assets during the financial crisis of 2008-2009 and compare the results to the value relevance during the normal economic period of 2012-2013. Using quarterly data from the banking industry we find that, first, although both fair value disclosure and non-fair value disclosure provide investors with decision-related information, the value relevance of fair value assets is slightly greater than value relevance of non-fair value assets, and this difference is larger during recession period. Second, the value relevance of Level 3 financial assets, which are computed using the greatest amount of management discretion, is lower than the value relevance of Level 1 and Level 2 financial assets, and lower than the value relevance of non-financial assets. This result is true in the recession period and the normal economic period. Finally, corporate governance appears to have a positive impact on bank stock prices, and fair value disclosure is more useful for firms with weak corporate governance.

3) Kisseleva, K.; Lorenz, D. 2016. Are Level 3 Fair Values Reflected in Firm Value? – Evidence from European Banks. ARCA workshop participants at Vrije Universitaet Amsterdam.

Abstract: This paper investigates whether, and if so, to what extent, Level 3 fair values disclosed by European banks provide useful information to investors and are reflected in firm value changes. Using a unique sample of 416 hand-collected firm-year observations from European banks reporting under IFRS, in contrast to previous research conducted in the US, we find no overall evidence that changes in Level 3 fair values are associated with changes in firm value. However, the value relevance of Level 3 fair values depends on the category assigned to financial instruments. Level 3 fair values that are held for trading are reflected in firm value. Further analyses suggest that this effect is driven predominantly by banks that operate in market-based economies and hire audit firms with deep industry expertise.

4) Short, D. 2012. SFAS 157 & the Market's Assessment of Fair Valued Assets: An Examination of Fair Valued Assets Held by Financial Firms During and Following the Financial Crisis. http://repository.upenn.edu/wharton_research_scholars

Abstract: Introduced in late-2007, SFAS 157 redefined existing accounting standards concerning fair value accounting and significantly impacted financial reporting for financial institutions. Prior studies, using larger samples of financial firms, have concluded that Level 3 fair values (the most opaque and subjective fair values) were heavily discounted by the market. Consistent with prior studies, this analysis, which examined only the largest and most systemically important financial institutions during the crisis and post-crisis periods, shows that the market did indeed ascribed a discount to Level 3 fair values, both during the financial crisis and following the financial crisis. Adding to the literature, this paper also observes that Level 2 fair values were discounted by the market during both the crisis and post-crisis periods, although the discount was significantly greater during the crisis, a feature not observed for Level 1 or Level 3 fair values or examined in prior studies.

5) Goh, B.W.; Li, D.; Ng, J.; Yong, K. O. 2014. Market Pricing of Banks' Fair Value Assets Reported under SFAS 157 since the 2008 Financial Crisis. Electronic copy available at: http://ssrn.com/abstract=2432912

Abstract: We investigate how investors price the fair value estimates of assets as required by Statement of Financial Accounting Standards No. 157 (SFAS 157) since the financial crisis in 2008. We observe that Level 3 fair value estimates are typically priced lower than Level 1 and Level 2 fair value estimates between 2008 and 2011. However, the difference between the pricing of the different estimates reduces over time, suggesting that as market conditions stabilize in the aftermath of the 2008 financial crisis, reliability concerns about Level 3 estimates dissipated to some extent. Next, we examine whether Level 3 gains affect the pricing of Level 3 estimates because managers have discretion to use Level 3 gains to manage earnings and asset values upwards. We find that differences in Level 3 gains do not lead investors to price Level 3 estimates differently. Finally, we find evidence that the pricing of the Level 1 and Level 2 fair value estimates of assets is lower for banks with lower capital adequacy. Overall, our study contributes to an improved understanding of the relation between valuation and fair value information.

6) Tan, P. 2015. Fair Value Hierarchy Measures: Post-Implementation Evidence on IFRS 7. Journal on Business Review (GBR). 4 (1): 105-113.

Abstract: Using a balance sheet valuation model, this study examines if information on the fair value hierarchy of on-balance sheet financial assets and financial liabilities are incorporated in the market's valuation of companies' equities in Singapore. The results of the study show significant associations between as-reported Level 1 and Level 2 fair value measures of financial assets and market values. However, the results are not significant for Level 3 fair value measures of financial assets and each of the three levels of fair value measures of financial liabilities. The results also show that returns are more positively associated with as-reported gains and losses from Level 1 and Level 2 fair value measures than those from Level 3 fair value measures. Overall, the evidence suggests that information on the fair value hierarchy of IFRS 7 Financial Instruments: Disclosures are used by market participants in their pricing decisions. The market however appears to place greater weights on fair value changes taken to the income statement than those taken to OCI, notwithstanding the level of the fair value measure. While the fixation with income statement measures remains a puzzle, the results are consistent with prior studies that show that investors largely ignore OCI in their pricing of shares.

7) Billiot, M.; Joo, T.T.; Melendrez, K. D. Market pricing of fair value measurements for non-financial firms. Journal of Finance and Accountancy. 6: 1-18

Abstract: Prior research has examined the value relevance of fair value measurements for financial firms. However, prior research has not examined the value relevance of fair value measurements for non-financial firms since the issuance of SFAS 157. Non-financial firms represent approximately 80% of firms, and they hold significant amounts of fair value assets. Therefore, it is important to document investors' perceptions of non-financial firms' fair value measurements. This study provides evidence on the value relevance of fair value asset and liability measurements for non-financial firms. The results show that Level 1 and 2 fair value asset measurements are value relevant and positively associated with stock prices. However, Level 3 fair value measurements are negatively associated with stock prices. This is inconsistent with both predictions and the results for financial firm in prior studies and in this study. This result suggests that investors penalize non-financial firms for investing in Level 3 fair value assets, perhaps because investors perceive that better investments are available. Finally, the results show that in contrast to evidence for financial firms, Level 3 fair value liability measurements are not value relevant. Overall this study documents and provides evidence on the value relevance of fair value measurements for non-financial firms which has not been explored by prior research.

3. Stage 2 – Answers from Brazilian Public Companies and Experts in Valuation

In the stage, a sample composed of Brazilian public companies were invited to collaborate with us sending their comments about the PIR IFRS 13 request for information.

Aiming to preservate the original answers, we chose to demonstrate it in an Excel workbook, respectively, contain the companies answers in lines and the questions in the columns. Please see an attached file named: Stage_2_Brazilian_Answers_PiR_IFRS_13

4. Stage 3 – Participation from investments analysts and professionals

As mentioned above, investments analsts and professionals were required to participate in thir comment letter structure trhough their class association APIMEC.

The free-translation of the Apimec's letter received by e-mail on September, 18, representing the analysts' concern about the fair value issue is presented below:

"Dear Eduardo Flores,

According to your request, the results of the "Research - Measurement of Fair Value - IFRS 13 PIR" are sent to Apimec's Regional members, which includes São Paulo, Rio de Janeiro, Porto Alegre, Minas Gerais, Brasilia and Northeast. In addition, Apimec Nacional was asked to disseminate the Survey to its base of Securities Analysts (AVM), Accredited, Certified and Licensed, so that we could have a relevant scope on the subject, which is fully inserted in the daily routine of the AVM, reflecting significantly in the final opinion of its work, the Analysis Reports, with Recommendations of Purchase, Maintenance and Sale. Also based on this sample of AVM, we highlight the relevant participation of the members of the Advisory Committee of the Securities Analyst (CCA), a group formed from the implementation of AVM self-regulation, authorized by the Brazilian Securities Commission (CVM) 483.

On this basis, according to the research statement and objectivity of the question, we obtained a return of 176 professionals, which we consider important, given the statement of some respondents not to be subject to applicability in some monitored sectors.
Considering that there is a maximum priority for Level 1 inputs and a minimum priority for Level 3 inputs, where Level 1 inputs are quoted prices, unadjusted, in active markets for identical assets or liabilities, which the company can access at the measurement date ; that Level 2 inputs are those that are not quoted prices included in Level 1 and that are observable for the asset or liability, either directly or indirectly; that Tier 3 inputs are inputs not based on observable market data, ie, based on unobservable data; the AVM made it clear that:

- The information required by IFRS 13, in addition to being useful, is essential for its work, where the wealth of information, besides what is determined, is always praiseworthy, independent of the costs that can be generated to have them, to generate the best and best possible transparency to the assumptions and basis of the analyzes.

- Certainly there are differences and there are increments for the accounting reading of the items that are discriminated as being evaluated by levels 1,2 and 3. The lower level, because it is closer to the real market conditions, presupposes greater confidence in the information, whereas in the level 3 is

uncertain about the discount rate used and the projected growth. Therefore, at Level 3 because it has a lower level of confidence, its prompt prompts the AVM to consider the need for additional verification work if such item is relevant to the purpose of the analysis. Therefore, it is very important and important to indicate the level that is being carried out the evaluation of the fair value of an equity item.

- Failure to recognize the company in adopting an appropriate level (1, 2 or 3), or that better reflects the need for information requires sometimes insistent approaches to reach the adequate value of the asset / liability (financial / non-financial; / non recurrent) now in evidence. In this case, there are those AVMs that, due to the difficulty in obtaining the information, or even the difficulty in the origin of such information within the company, prefer to assign degree of punishment, according to their own models, to the level of Governance.

Ricardo Tadeu Martins – President
Eduardo Werneck – Vice President

Catarina Pedrosa – Technical Director

The National Apimec makes itself available for new research whenever it is necessary."

Please see an attached file named: Stage_3_Apimec_Letter