



Global Financial Crisis & IFRS





Good *morning*



The Background

- Significant **global economic growth** over an extended period
- The commodity and growth “**SUPER CYCLE**”
- **Property boom** in US and Euro Zone
- **Financial engineering** (securitizations etc) and **leveraging**
- Global **interconnectedness** of financial markets
- Globalization of the **Real Economy**
- Just a little bit of **Greed?**



Pressure points

- **Inflation** and **interest rate cycle** on an **upward trend globally**, US, China, Europe, developing world
- International **oil prices** at all time highs nearing **US\$147**
- Looming **recession fears** in the **US** and Euro-Zone
- Fears of **slowing growth** in China
- US **property market** taking strain from slowing US economy, increasing interest rates, and fears of possible housing over-supply



Trigger points

- Concerns about the underlying **quality** of the engineered financial assets
- Assets are sold in an atmosphere of **uncertainty** at deeply discounted prices, **triggering more selling at even deeper discounts**
- **The contagion effect of CDOs**
- Investment and retail banks are holding some of this **“toxic paper”** and after taking into account mark-to-market losses on these assets **solvency and liquidity concerns are raised**



What is the Financial Crisis?

First Round Effects

- **CREDIT CRISIS**
- **LIQUIDITY & SOLVENCY CRISIS**
- **CRISIS OF CONFIDENCE**



What is the Financial Crisis?

Second Round Effects


- Credit-Led Global Recession
- Further declines in global **business and consumer CONFIDENCE**
- Flight to “relative safety”



What is the Financial Crisis?


“Third” Round Effects

- Concerns around mark-to-market
- Amendments to IFRS
- IFRS US GAAP Convergence



Taking Stock

- Lehman Bros, Merrill Lynch, AIG, Bear Stearns, Northern Rock, WaMu all gone or nationalized
- Stock markets at **10 year lows**
- Major car manufacturers under major pressure, **GM, Chrysler, Ford**
- Commodity price crashes, copper, diamonds, crude oil, nickel (averaging **50-60%** drop since highs of 2007/08).
- **Global Tourism** a silent victim



Interventions to date

- US Congress eventually approves **US\$700bn** bail out plan in late 2008- more than **US\$1 Trillion** earmarked for recovery package
- **AIG** bailed out for over **US\$160 billion** (made a record quarterly loss of US\$62bn to Dec 2008)- where did the money go?
- **G20 still discussing the formulation of integrated approach**-where is the rest of the world?
- UK government announces £50bn mini rescue plan
- Significant portions of many British banks by size now effectively **nationalized, RBS, Northern Rock, Lloyds TSB**



IFRS Guidance



1. Fair value vs. fundamental value
2. Active vs. inactive market
3. Forced sales
4. Different estimates of fair value
5. Valuation adjustments



Fair value vs. fundamental value

1

- Fundamental approach looks through to underlying **expected cash flows** from the instruments based on **management's estimates**
- Some argue in times of **market turmoil** or market crisis, **market prices** are not reflective of fair value
- Guidance indicates that this "**fundamental value**" approach **may not** be consistent with fair value of it **does not** take into account the reality of illiquid markets in arriving valuations



Active vs. Inactive value

2 Undue emphasis on active vs. non-active market **distinction**

- The fact that a market is **inactive** is not necessarily indicative that market prices are not a fair reflection of fair value
- **Cannot** ignore transactions that do place in an inactive market



Active vs. Inactive value

2 Use a valuation technique that takes into account market transactions and existing **market** conditions

- Make reference to the fair value of “*similar*” assets where applicable



Forced Sales

3 Forced sales considered **rare** and evidence required to prove it was forced e.g.

- Legal requirement to transact
- Necessity to dispose with insufficient time to market the asset
- Existence of a single potential buyer as a result of legal or time restrictions imposed


- Even if a sale is forced, **evidence** is required to show that the price is not reflective of fair value



Different fair value estimates

4


- Where there is **no** active market for an asset a valuation technique is used
- It is possible for 2 or more entities holding the same asset to have **different** fair values for that asset and for both entities to comply with the accounting requirements of fair value



Different fair value estimates

4


- Differences arise from different **valuation** models or assumptions of management
- **IFRS 7** requires disclosure of those techniques and assumptions



Fair value adjustments


5

- Where there is **no** active market for an asset a valuation technique is used
- **Adjustments** may relate to:
 - Model deficiencies & recalibration
 - Liquidity adjustments
 - Credit adjustment




Fair value adjustments


5 “**Reserve accounting**” permissible provided it adjusts pricing towards fair value i.e. the price at which a transaction would have occurred at measurement date



Other Guidance



- **Detailed guidance** on fair value in inactive markets
- Disclosure
 - **IFRS 7** impact
 - Aggregation and granularity of data
 - Changes in risks, assumptions, and fair value techniques
 - Disclosure of particular interest to users
 - **IAS 34** impact
 - Updated disclosures may be required in interim financials





Amendments to IAS 39 and IFRS 7

(December 2008)

Why?

- Issued in response to pressure from IFRS reporters
- Wanted level playing field with US GAAP
- Wanted to be able to reclassify certain non-derivative financial assets out of fair value categories



General Rule: Can't reclassify a financial asset after initial recognition!



Reclassification

Financial Assets (other than those that would have met the definition of **loans and receivables**)



May reclassify to another category provided no longer held for the purpose of selling or repurchasing it in the near term in **RARE CIRCUMSTANCES!**



When do these reclassifications apply?

What's a...


RARE CIRCUMSTANCE???


The global credit crunch?




IASB View of Rare

- IASB indicated that '*rare circumstances*' arise from:
 - a single event that is unusual and
 - highly unlikely to recur in the near term.



South African View 

- APB in SA is of the view that it is **highly unlikely** that there are such 'rare circumstances' currently in South Africa.
- However, there may well be 'rare circumstances' affecting South African companies that have operations or financial assets in *other countries* that have such 'rare circumstances'.



Consequential Changes to IFRS 7

Disclose:

- Movements into and out of each category
- Annually, the carrying amount and fair value of items reclassified
- The **“rare situation”** necessitating the reclassifications
- Annually, the fair value gains and losses that **would have been disclosed** had the reclassification not occurred





Transition and Effective Dates

- An entity shall apply those amendments from **1 July 2008**. An entity shall not reclassify a financial asset in accordance with these amendments **before 1 July 2008**.
- Any reclassification of a financial asset made in **periods beginning on or after 1 November 2008** shall take effect only from the date when the reclassification is made.
- Any reclassification of a financial asset **shall not be applied retrospectively to reporting periods ended before the effective date set out in this paragraph**.



Transition and Effective Date

- IFRIC 16 is effective for annual periods beginning on or after **1 October 2008**
- Prospective, *however*:
 - Must evaluate all hedges on date of adoption to ensure they qualify for hedge accounting
 - If not, stop hedging





Impact for Zambia





Tourism

Extractive Industries

Development Funding and Aid

Macro-economic



Impact for Zambia

- Tourism
- Extractive Industries
- Development Funding and Aid
- Macro-economic slowdown
 - Employment
 - Development expenditure
 - Budget pressures
- Millennium Development Goals

