

Spotlight on Brazil's plans to adopt IFRSs

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Brazil is one of a number of large economies making plans to adopt International Financial Reporting Standards (IFRSs). Robert Bruce, a financial journalist, looks into why the country has chosen to embrace international standards and how Brazil's increasing influence on the global stage is extending to financial reporting. His views are his own and may not represent those of the IASC Foundation or the IASB.



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Over the last fifteen years Brazil has been one of the great global economic successes. It has overcome generations of difficulty, and through decisive and consistent changes has created the infrastructure, institutions and culture which can foster success.

It is scarcely credible to compare the Brazil of today with the Brazil of just a few decades ago. It was only in 2001 when it started to be talked of as one of the economies of the future in the grouping with Russia, India and China, to form the media shorthand of BRICs. Until the early 1990s it was seen as an economy which had huge assets but which lacked the structure to provide long-term success. Inflation, the scourge of such economies, had long been out of control. Professor Nelson Carvalho, who as a Securities Commissioner and then Head of Banking Supervision at the Central Bank of Brazil in the early 1990s was one of the team of architects behind the change which has occurred, provides a simple reminder of how far Brazil has travelled in a short time. Take the long-term destruction of the currency. He points out that he is now 65 years old and over 45 years of his life, as he puts it, the currency lost 13 zeros. "I lived under hyper inflation until 1994", he reminds you, "and over the last 16 years we have had inflation of around 1.5 to 5%".

In the simplest of equations that has been revolutionary. "That has permitted institutional investors and manufacturers to consider Brazil in investment terms", he says. Between 1994 and 2009 Brazil received around \$330 bn in foreign direct investment. Now its economy is growing at an annual rate of 5%. It is expected to overtake both Britain and France over the next few years and move into fifth place in the ranking of world economies. It is now a stable democracy, has no significant internal conflicts, and has huge natural resources from food to minerals onshore and in oil reserves huge natural resources offshore. Its major companies are expanding across the world and overseas companies are establishing themselves in Brazil. Its place in the global economy is secure and expanding.

The measures taken in the 1990s have paid off. Then the Central Bank embarked on a policy of low inflation and sensible control over the country's banking industry. State industries were privatised and the economy was opened up to trade and investment from overseas.

Inflation has been brought under control supported by fiscal consolidation, and by a monetary policy framework combining floating exchange rate and inflation targeting. The Brazilian financial services industry benefited from increasing global economic and financial integration, providing a wide range of financial services and experiencing growing volumes of cross-border capital flows, with new opportunities and challenges. In such a broad-based economy and a highly developed financial sector, the Central Bank plays a central role in monetary policy and is responsible for the prudential regulation and supervision of a financial system that has proved its resilience in the period, including the recent international crisis.

Now the Brazilian economy is benefiting from those changes and the internal infrastructure is strengthening. Alexsandro Broedel is a Commissioner with the CVM, the Brazilian equivalent of the US regulatory body, the Securities and Exchange Commission. “With economic stability and inflation under control”, he says, “there has been a big process of change in the Brazilian capital markets with strong institutional development and rules to improve corporate governance. There has been a strong development of capital markets as a result: the development of real capital markets, with Brazilian companies listing on the Sao Paulo stock exchange and Brazilians buying shares”.

“This is clearly a moment when the country is being regarded as a stable, strong, democratic country”, says Amaro Gomes, until recently head of financial system regulation at the Central Bank of Brazil and now a board member at the IASB, ‘and high quality accounting is an essential step in the development of the country, attracting investment, reducing the cost of capital and providing access to international markets’.

It is in this context of a now-confident capital market system that the decision to move away from a domestic to a global financial reporting system was taken. Back in 2000, two years before the European Union took a similar decision relating to European companies, the Cardoso government set the legal process underway of supplanting the local Brazilian GAAP with IFRS. This finally cleared all the congressional hurdles in late December 2007 and was put into law on the 1st of January 2008.



Pedro Malan, former President of the Central Bank of Brazil and current IASC Foundation Trustee

In the words of Pedro Malan, former President of the Central Bank of Brazil when the economic plan (known as Plano Real) was launched in 1994, Brazil’s longest-serving Finance Minister, from 1995 until 2002, and Trustee of the IASC Foundation, the move to IFRS: “will be a major plus for Brazilian firms’ stature in international capital markets and among investors, analysts, auditors, ratings agencies, shareholders and stakeholders in general”.

Brazil has a broad-based economy and a highly developed financial sector” says Alexandre Tombini, Deputy

Governor for Financial System Regulation and Organization at the Central Bank of Brazil.”With the increasing global economic and financial integration of our country, it has become clear for us at the Central Bank of Brazil that convergence with

internationally accepted accounting standards is of utmost importance. Our belief is that high-quality standards are one of the key ingredients of efficient allocation and use of scarce economic resources and comparable financial information plays a key role in the financial decision-making process of investors”.

With an environment marked by monetary and financial stability and continuing economic growth, investors’ confidence is influenced by our consistent macroeconomic policies, and ability in reducing vulnerabilities and to mitigate the impact of economic shocks on domestic financial conditions, thus reducing the incidence of crises”, says Tombini. “At the same time, the adoption of high-quality financial reporting requirements by enterprises, built on accounting standards that are consistent, comprehensive, and based on clear principles, can reduce the severity of market disturbances since market participants are well informed and thus, are not as likely to overreact to information on current conditions”.

The gradual convergence of Brazilian GAAP with IFRS was set in train in 2006 for financial intermediaries under the supervision of the Central Bank and in 2008 for public companies with a deadline of 2010 for full convergence. In January this year a Memorandum of Understanding was signed between the relevant Brazilian accounting bodies and the IASB which confirmed the end of 2010 as the target date for full convergence and established a framework for future cooperation between the accounting bodies and the IASB.

“High-quality corporate reporting is essential for attracting and protecting investors not only because of comparability but also due to its close relationship with good governance, accountability and responsibility, enhancing investors’ confidence in the information prepared in such an environment”, says Tombini. “Corporates should, in theory, benefit when they provide comprehensive, relevant and timely information on their financial conditions, performance, and risk management practices. Such businesses should be able to access capital markets more efficiently than similar companies that do not provide information in the same level and thus reducing the cost of capital, and as already said, making the allocation of economic resources more efficient”, he says.

“People wanted something new and better and knew they had to move to a new set of accounting standards to avoid affecting investment”, says Commissioner Broedel. “Companies with shareholders in the US, Europe and Brazil used to have to produce three sets of accounts, under US GAAP, Brazilian GAAP and IFRS. In one set you could show a loss and in another a profit and you had to explain that. Now Brazilian GAAP will not exist from 2010 on and all accounts will be published under IFRS”.

The changes will also create a revolution in the world of Brazilian small and medium-sized enterprises, (SMEs), which will be using the IFRS for SMEs. At present it is already available in the form of the exposure draft but from June this year companies will be using the final form of the standard.

“According to recent figures, the estimated number of SMEs in Brazil in January 2009 was 5.9 million, representing 99% of Brazilian enterprises”, says Tombini. “With that number in mind anyone can easily imagine how beneficial an enhanced accounting model for such entities is expected to be in our country. Although it is not expected that all of them will use the standard, because the Brazilian SMEs law allow the smallest ones to keep a simplified accounting system, a significant number of SMEs will have to use the SMEs standard, because they are requested by providers of finance, mainly banks, or are organized enough to do so”.

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Nelson Carvalho suggests that this revolution will transform the management of such companies and enable them to be a much more effective part of the economy. “There are millions of SMEs in Brazil, and collectively they are a very big employer”, he says, “but there is a very high mortality rate at the SME level. That is because of poor management and that is down to poor information. The financials were tax-driven and were not being used for management purposes. Now we need to help these managers so they have a better understanding of their companies. And that in turn will improve the number of jobs which SMEs will create”. “As for public companies”, says Tombini, “I believe SMEs presenting a greater level of financial transparency can experience easier access to finance at a lower cost”.

There is a considerable challenge ahead with extensive training projects for the members of the Brazilian accounting profession. And the memorandum of understanding envisages enhanced cooperation and the fostering of greater participation between the Brazilian standard-setting community and the IASB. “It will take time”, says Gomes, “but the memorandum is an incentive for accountants, analysts, investors and users to be more organised”.

“In Brazil, discussions on accounting and auditing convergence have been ongoing for quite some time”, says Tombini. “Regulators, accountant associations and market representatives have actively taken part in the debate. The Central Bank of Brazil has long been a strong supporter of international, high quality, accounting standards developed by the IASB. With the increasing global economic and financial integration of our country, it has become even more apparent for us at the Central Bank that convergence with internationally accepted accounting standards is of utmost importance”, he says. “In my view, the IASB should persevere in taking into consideration the wide variety of practices and business environments around the world in order to faithfully represent such a diverse, global, environment. We are committed to contributing with IASB’s goal in developing an accounting model that truly captures expectations of constituents around the world”.



Professor Nelson Carvalho

As a result the extraordinary Brazilian model of how to foster secure economic growth, international acceptance, and a strong position in global markets has been further reinforced by the move to IFRS. “A more commonly understood language will be of enormous benefit”, says Nelson Carvalho. “That was the main engine behind the change”. And it will continue in the process of giving Brazil a greater platform on the world stage. And these developments suggest that they intend using their new-found stature to make an impact on the way global decisions are taken. There is no coincidence that the IASB now has a former Brazilian finance minister, Pedro Malan, as a trustee, a past head of financial system regulation at the Central Bank of Brazil, Amaro Gomes, as a fulltime Board member and a onetime Head of Banking Supervision at the Central Bank of Brazil as a past Chairman of the IASB’s Standards Advisory Council. It is all part of a wider trend which embeds Brazil’s influence and authority in the global economy.