

28 June 2004

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Rt. Hon Jacqui Smith MP
Minister of State for Industry and the Regions
Department of Trade and Industry
1 Victoria St.
London SW1H 0ET



From the Office
of the Chief Executive

Dee Minister of State

Endorsement of IAS 39

The Institute of Chartered Accountants in England and Wales is the largest accountancy body in Europe, with more than 126,000 members operating in business, public practice and within the investor community. The Institute operates under a Royal Charter, working in the public interest.

We commend the consistent support of the UK Government for the EU Regulation on International Accounting Standards and for the early endorsement by the European Commission of a comprehensive set of accounting standards for application in 2005 by EU listed companies. The Institute has been a prime advocate of the use in Europe of the accounting standards published by the International Accounting Standards Board (IASB). The availability of consistent and comparable financial information will contribute to a progressive improvement in levels of confidence amongst investors and to enhanced capital market competitiveness and efficiency.

We are seriously concerned that there is still uncertainty regarding the endorsement of the financial instruments standard IAS 39, *'Financial Instruments: Recognition and Measurement'*. Any decision by the European Commission to postpone full endorsement of the complete set of IASB standards applicable in 2005, including a fully-updated version of IAS 39, would disadvantage both business and investors. It would bring into question the quality of financial reporting in Europe and would result in a European set of accounting standards, closely aligned with IASB standards, but applied on a regional basis and less demanding. It would also prolong or exacerbate uncertainty for EU companies seeking to address the formidable challenges of migration to the new accounting regime.

We recognise that there continue to be significant concerns regarding IAS 39. One key concern is the potential for greater volatility in the financial statements of banks. However, to the extent that this reflects the volatility inherent in market prices, this is appropriate, ensuring that financial statements are transparent and portray economic reality. Whilst some reported volatility will result from the mixed valuation model embedded in the current accounting framework, only a move to a comprehensive fair value model in financial reporting would address this. This is not a realistic prospect in the near term given the many unresolved questions about this type of model.

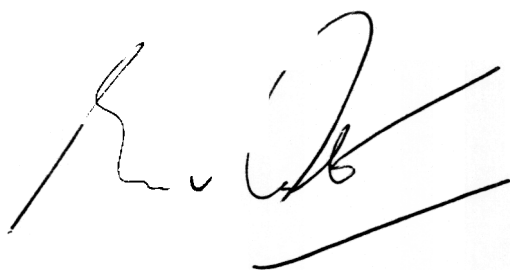


A related concern is the accounting treatment of certain hedging transactions. Hedge accounting can be used to reduce any artificial volatility caused by having a mixed accounting model. However, there are still conceptual and practical difficulties with the IAS 39 hedging model. The IASB recognised early on that changes were required to make IAS 39's hedging requirements more practical and intensive negotiations have taken place between the IASB and the banking sector regarding possible short-term improvements. At present, no alternative model for accounting for financial instruments has been developed which is demonstrably better in conceptual and practical terms. The IASB is, however, committed to a more comprehensive reform of IAS 39 in the medium-term and has related projects underway on the reporting of financial performance and measurement bases in accounting.

We have urged the IASB to complete these major projects at the earliest possible opportunity. In the meantime, we urge the UK Government to continue to seek early endorsement of the latest version of IAS 39, unamended and unabridged. Anything less is likely to lead to long-term damage to the credibility and quality of European financial reporting.

Please do not hesitate to contact me if you require further information. This letter will be made available on the Institute's website in view of the importance to the public interest of the matters covered.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Eric Anstee', with a long horizontal stroke underneath.

Eric Anstee