

Accounting Standards Board

ASB Announces Way Forward on IAS 39

ASB PN 256

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The Accounting Standards Board (the Board) is today issuing this statement on the implications for UK financial reporting of the modified version of International Accounting Standard (IAS) 39 'Financial Instruments: Recognition and Measurement' proposed by the European Commission.

EU decision on IAS 39

On 1 October 2004 the EU voted to adopt as an EU-adopted international accounting standard a version of IAS 39 that has been amended by the European Commission ('amended IAS 39') rather than IAS 39 as published by the IASB (the 'unamended IAS 39'). This decision raises important issues both for the Board and for companies in the UK.

ASB conclusion

The ASB strongly supports the view that all UK companies should comply as far as possible with the full hedging provisions of the standard and not the amended version, and we will be issuing guidance on this and the amended fair value option as soon as possible.

ASB action for companies following EU-adopted international accounting standards

Hedge accounting

The implications of the EU's decision for entities reporting under EU-adopted international accounting standards are not straightforward. The Board has considered how it believes UK entities applying EU-adopted international accounting standards should proceed, and has concluded that it should strongly recommend compliance with the hedge accounting requirements in full.

In this regard the following points are relevant.

- The European Commission has stated that Member States are permitted to require companies reporting under the IAS Regulation to comply in full with the hedge accounting requirements of IAS 39. If this power to mandate full compliance lay with the Board, it would do so immediately. However, the Board understands that, as a consequence of the IAS Regulation, the Board may not currently have this power. The Board intends to explore all possible means of mandating compliance with the hedging requirements as soon as possible.
- There remains considerable uncertainty about how the EU's proposed interpretation of IFRS 1 'First-time Adoption of International Financial Reporting Standards' will work in practice. The Board suspects that applying that interpretation might raise issues for some enforcement agencies and might also create difficulties for the companies involved when the EU-adopted version of IAS 39 is eventually brought into line with the IASB's version. Compliance in full with the deleted hedge accounting requirements from 2005 will avoid these problems.

The fair value option

Many UK entities that will be reporting under EU-adopted standards had intended to use the fair value option more widely than now permitted under the amended IAS 39 – for example to eliminate the artificial volatility that would otherwise arise from accounting for linked transactions on differing bases, or to simplify the application of the standard by using fair value in place of detailed hedge accounting requirements. There is, as a result, much interest in understanding precisely the effect of the EU's decision.

Guidance to be issued

The Board understands the concerns of UK companies and their urgent need to know the implications of the amended fair value option for their 2005 reporting – accounting systems need to be operating in compliance with the standard from 1 January 2005. The Board intends to issue guidance as soon as possible on these issues. This will set out its views on the interaction between the amended IAS 39, other adopted international standards and the legal requirements.

ASB action for companies following UK standards

To date the Board has been following a convergence process that will ultimately mandate compliance with unamended IAS 39 by all companies that are continuing to follow UK standards. Notwithstanding the EU's decision, the Board has decided to continue with that strategy. As a result, a UK standard implementing in full the measurement and hedge accounting requirements of the unamended IAS 39 will be issued shortly, and will apply to 2005 year-ends for all listed entities still following UK standards, and from 2006 for certain unlisted entities. Further proposals on extending the scope of that standard to other entities and on implementing the recognition and derecognition parts of the standard will be issued next year.

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Commenting on the Commission's actions, Ian Mackintosh, ASB Chairman, said:

"The position the EU has reached on adoption of IAS 39 is unsatisfactory.

The adopted standard includes seriously weakened hedge accounting requirements and may give rise to artificial volatility in reported profits and difficulties in application as a result of limiting the fair value option.

There is also considerable uncertainty over the application of the adopted standard and its relationship to EU law, and those UK companies that will be applying international standards now have little time to address these difficult issues in order to implement the standard for 2005. Nor is it clear that these problems will in fact be resolved quickly.

Today's statement by the ASB and the guidance we will issue shortly will help provide UK companies with the clarity that they need."

END

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Notes to Editors

1. The Accounting Standards Board is a board of the Financial Reporting Council (FRC).
2. The role of the ASB is to issue accounting standards. The ASB collaborates with accounting standard-setters from other countries and the International Accounting Standards Board (IASB) both in order to influence the development of international standards and in order to ensure that its standards are developed with due regard to international developments.
3. From 2005 the financial reporting framework in the UK and the Republic of Ireland will change, with some companies continuing to report under the existing framework and others (listed groups and some other entities) reporting under EU-adopted international accounting standards. Prior to 1 October, no amendments to standards have been made in the adoption process. However, IAS 39 'Financial Instruments: Recognition and Measurement' has proved controversial and the Commission has put forward an amended version for adoption.
4. The vote on 1 October was taken by representatives of EU member states, meeting as the Accounting Regulatory Committee (ARC). A qualified majority voted in favour of the amended version of the standard. The vote is not the final stage in the EU adoption process but it is a strong indication of the outcome.
5. Amended IAS 39 differs from unamended IAS 39 in two respects. Those differences and their implications are as follows:
 - a. The fair value option in unamended IAS 39, which permits companies to designate any financial instrument as an instrument to be measured at fair value with the changes in that fair value taken to the profit and loss account has been restricted so that it does not apply to financial liabilities. The implication appears to be that, unless it is appropriate to invoke the fair presentation override set out in IAS 1, financial liabilities can be measured at 'fair value through the P&L' only when otherwise permitted or required by the standard i.e where liabilities that are derivatives, are held-for-trading or are accounted for in accordance with the standard's requirements for fair value hedges. The EU has also indicated that the EU accounting directives have a bearing on the extent to which fair valuation can be applied to liabilities and the Board intends to examine the implications of this interpretation in more detail.
 - b. Some of the criteria that unamended IAS 39 requires to be met if a hedge relationship is to qualify for hedge accounting have been deleted, thus enabling a wider range of relationships to qualify for hedge accounting. However, in contrast to the amendment to the fair value option, there is nothing in the amended standard or its surrounding material that prevents an entity from complying with both hedge accounting requirements of the amended standard and the deleted hedge accounting requirements. Thus it is possible for an entity to comply with both the amended standard and the unamended standard as long as it does not make greater use of the fair value option than the amended standard permits.
6. The ASB's strategy for convergence was set out in 'UK Accounting Standards: A Strategy for Convergence with IFRS' issued in March 2004, and the detailed proposals for implementation of IAS 39 for entities adopting UK standards were issued in FRED 30 'Financial Instruments: Disclosure and Presentation & Recognition and Measurement' (June 2002) and its Supplements (August 2003, April 2004 and July 2004).