

Frequently Asked Questions (FAQ) on Financial instruments: recognition and measurement - IAS 39 The Fair Value Option

(see also [IP/05/884](#) and [MEMO/04/265](#))

Why did the Commission carve out the full fair value option in the original IAS 39 standard ?

The Commission carved out the provisions relating to the full fair value option because of concerns expressed by the European Central Bank and prudential supervisors represented in the Basel Committee of banking supervisors. The IASB recognised these concerns and was working on the preparation of an amended IAS 39 standard for a restricted fair value option.

Given that EU undertakings had to apply International Financial Reporting Standards (IFRSs) from 1st January 2005, the Commission decided on 19th November 2004 that the only available course of action in the circumstances was to adopt the original IAS 39 standard leaving out certain parts of the standard that were considered not suitable. (Certain provisions relating to hedge accounting were also carved out.) The Commission is not a standard setter and has no intention of becoming one. The two carve-outs were exceptional and temporary pending adoption of the improved standards by the IASB. After extensive consultation with third parties, on June 16th 2005 the IASB published an amended version of IAS 39: Recognition and Measurement – the Fair Value Option (FVO).

Do prudential supervisors support IAS 39 FVO as published by the IASB ?

The amended standard benefits from wide support, both from the financial services industry as well as from the European Central Bank and the Basle Committee of banking supervisors.

When will the Commission to adopt amended standard for IAS 39 FVO?

Given the importance of rapid endorsement of the amended standard, the Commission has prepared a draft Commission Regulation which was unanimously approved by Member States at the Accounting Regulatory Committee on 8th July.

The Commission has consulted the European Parliament on the draft Regulation and, provided Parliament raises no objections, it is the Commission's intention to formally adopt the amended standard as soon as possible. Subject to the availability of all language versions, formal endorsement by the Commission should take place by end September.

Will companies be able to apply the amended standard for their 2005 financial statements ?

Adoption will be retroactive to 1st January 2005, so that companies can apply the amended standard for their 2005 financial statements. In particular, although formal endorsement by the Commission should take place by end September, the Commission would draw attention to the requirement under the transitional arrangements for the designation of financial assets and liabilities at fair value through profit and loss to be completed by 1st September 2005.

Does the amended standard for IAS 39 FVO meet the EU endorsement criteria ?

The Commission considers that the amended standard meets the criteria for the adoption of an international accounting standard under Article 3(2) of the IAS regulation. In particular, the amended standard is not contrary to the principal of providing a "true and fair view" of a company and is conducive to the European public good. Whereas the fair value option under the original standard was unrestricted, the amended standard provides for a restricted, principles-based fair value option whose application is combined with extensive disclosure requirements.

What about the relationship between the fair valuation of own liabilities under the amended IAS 39 FVO standard and under Article 42(a) of the Fourth Company Law Directive ?

The Commission has given careful consideration to the fact that the amended fair value option permits the fair valuation of own liabilities, in particular own debt instruments, whereas this is prohibited under Article 42(a) of the Fourth Company Law Directive. This prohibition does not present a legal impediment to the adoption of IAS 39 FVO. Indeed Recital (9) of the IAS Regulation explicitly states that subject to the application of a standard resulting in a "true and fair view of the financial position and performance of an enterprise", there does not need to be "a strict conformity with each and every provision of the accounting directives."

Will the Commission now propose amending Article 42(a) of the Fourth Company Directive?

The established policy of the Commission has always been to seek to have a relatively homogeneous accounting environment in the EU between listed companies, falling under the IAS regulation, and non-listed companies, falling under the accounting Directives. For precisely this reason, the Commission adapted the existing accounting Directives by means of the so-called Fair Value and Modernisation Directives¹. Consequently, the Commission now proposes to examine whether the 4th Company Law directive should be amended and if so, how.

Are the different approaches to the fair valuation of own liabilities under the amended IAS 39 FVO and the 4th Company Law Directive manageable?

Pending examination of possible amendment to the 4th Company Law directive, the Commission considers that the different approaches under IAS 39 FVO and the 4th Company Law Directive will be manageable for a number of reasons.

- The amended IAS 39 Fair Value Option is restricted and its application subject to the respect of principles.
- Furthermore, its application is combined with extensive disclosure requirements that will allow users and analysts to assess the impact of the FVO.
- As regards prudentially supervised entities (e.g. banks or insurers), whether these are listed or non-listed, prudential supervisors will be able to take action by invoking their supervisory powers, where they consider that the accounting practices used lead to inappropriate results from a prudential perspective.

What about the remaining IAS 39 carve-out relating to certain hedge accounting provisions?

As regards the removal of the carve-out relating to certain hedge accounting provisions, the Commission has been closely monitoring the on-going discussions between the European Banking Federation and the IASB. The Commission calls upon both the European Banking Federation and the IASB to redouble their efforts to find an appropriate technical solution as rapidly as possible. In the interim, the Commission reminds interested parties of the legal position regarding the excluded hedge accounting provisions. Because there is no existing EU law on this issue, individual companies may apply the 'carved out' hedge accounting provisions, if they wish to do so.

For further details see:

http://europa.eu.int/comm/internal_market/accounting/ias_en.htm

¹ Fair Value Directive (2001/65/EC) and Modernisation Directive (2003/51/EC).