

Financial Services Authority

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FSA publishes consultation paper on International Accounting Standards

FSA/PN/088/2004

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The FSA has today announced that it proposes to keep to a minimum the changes needed in its regulatory accounting rules in the light of new accounting standards. The proposed changes are published in a consultation paper today and reflect the introduction of International Accounting Standards (IASs) and the increased use of fair value principles. Under EU accounting requirements all listed companies will be required to use IASs for their annual consolidated financial statements from 1 January 2005.

Michael Folger, the FSA's Director of Prudential Standards, said:

"The accounting standards for regulated firms are undergoing great changes with the introduction of IASs for listed firms and moves to converge UK accounting standards with IASs. To give firms some stability for their planning, we are proposing the minimum changes necessary to ensure that financial accounts can continue to form the basis of the regulatory capital framework.

"The changes in accounting standards, and firms' application of them, are likely to shake down through the next couple of years. So we look to revisit the implications for our rulebook on that timescale."

The proposals present a pragmatic approach that involves the least disruption to firms in meeting FSA requirements. The FSA's long-term objective is to promote the convergence of

accounting, economic and regulatory measures of capital.

The paper proposes four key changes to the financial reporting made by regulated firms. The proposed rule changes are needed to allow the FSA to continue to apply the same prudential requirements to firms, as the results would be different if the revised accounting standards were applied without making adjustments. Of these changes, the first three relate to the figures produced under IAS 39:

*- in the treatment of cash-flow hedges, we propose to eliminate from the measurement of regulatory capital all fair value gains and losses arising from the fair valuation of derivatives that have been accumulated in equity;

- in the treatment of available-for-sale assets we propose to follow the US approach and to leave equities at fair value, but write available-for-sale debt instruments back to cost or amortised cost;
- for fair value options we propose that unrealised gains or losses arising from the fair valuation of a firm's own credit risk should be eliminated from regulatory capital; and
- in accounting for defined benefit pension schemes we propose that the accounting measure of actuarial losses should be eliminated for regulatory purposes. It should be replaced by the company's best estimate of the level of additional funding that it will need to provide for its pension scheme over the next five years.

Notes for editors

1. The consultation will close on 31 January 2005. After considering responses, we plan to make the rules in April 2005 to take effect from 1 July 2005. The consultation paper can be found [here](#) on our website.
2. Under the IAS Regulation (the EU regulation on the application of IAS) all EU listed companies will be required to use IASs for their annual consolidated financial statements from 1 January 2005. The IASs will replace the use of UK Generally Accepted

Accounting Practice (UK GAAP). This was explained in the July Quarterly CP which can be found [here](#) on our website.

3. The FSA has written to the Chief Executives of all listed companies reminding them of the need for disclosure of their application of IAS 39 and stating that we will allow listed companies more time to prepare their first interim accounts under International Financial Reporting Standards. The text of the letter was placed on our website today and can be found [here](#).
4. The FSA believes that there are two key reasons for making adjustments before calculating the prudential figures. First the International Accounting Standards Board (IASB) and UK Accounting Standards Board (ASB) are moving increasingly towards the use of fair value, rather than historical cost, for the measurement of financial assets and liabilities. This gives information that is more relevant to users of financial statements, but the results can be less reliable and more volatile than using an historical cost approach. Second, the UK prudential framework has been closely tailored to UK GAAP's principles of recognition and presentation. The ASB is committed to a programme of converging UK GAAP with IASs, but significant differences remain.
5. The changes proposed in this CP arise primarily from the application of the IASB and UK accounting standards measuring financial instruments and accounting for pension costs. There is still uncertainty about the ways these standards will apply in the EU from 1 January 2005. The proposals in this paper are short-term solutions that meet our statutory objectives of maintaining market confidence and protecting consumers. We intend to reconsider all these issues in two years' time (or earlier if appropriate) when the accounting position will have become clearer.
6. The FSA regulates the financial services industry and has four objectives under the Financial Services and Markets Act 2000: maintaining

market confidence; promoting public understanding of the financial system; securing the appropriate degree of protection for consumers; and fighting financial crime.

7. The FSA aims to maintain efficient, orderly and clean financial markets and help retail consumers achieve a fair deal.