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**EUROPEAN COMMISSION**

Internal Market DG

FINANCIAL MARKETS  
**Accounting and auditing**

Brussels, 6 September 2004  
G5 D(2004)

## **THE ACCOUNTING REGULATORY COMMITTEE**

### **ARC**

**MEETING ON 8 SEPTEMBER**

**WORKING DOCUMENT ON IAS 39**

The attached Draft Commission Regulation and the Annex does neither prejudice the final position of the Commission on the endorsement of IAS 39 *Financial Instruments: Recognition and Measurement* nor will the Member States be asked to vote on this text at the next meeting of the Accounting Regulatory Committee (ARC) on 8 September 2004.

This document has been made publicly available on the Commission's web site under [http://europa.eu.int/comm/internal\\_market/accounting/ias\\_en.htm](http://europa.eu.int/comm/internal_market/accounting/ias_en.htm)

**DRAFT**

**COMMISSION REGULATION (EC) No .../..**

**amending Regulation (EC) No 1725/2003 on the adoption of certain international accounting standards in accordance with Regulation (EC) No 1606/2002 of the European Parliament and of the Council as regards the insertion of IAS 39**

**(Text with EEA relevance)**

THE COMMISSION OF THE EUROPEAN COMMUNITIES,

Having regard to the Treaty establishing the European Community.

Having regard to Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, and in particular Article 3 (1) thereof,

Whereas:

(1) By Commission Regulation (EC) No 1725/2003<sup>1</sup> certain international standards and interpretations that were extant at 1 September 2002 were adopted.

(2) On 17 December 2003 the International Accounting Standard Board (IASB) published revised International Accounting Standard (IAS) 39 Financial Instruments: Recognition and Measurement as part of the IASB's initiative to improve fifteen standards in time for them to be used by companies adopting IAS for the first time in 2005. The purpose of the revision was the further improvement of the quality and consistency of the body of existing IASs.

(3) On 31 March 2004, the IASB issued an amendment to IAS 39 Financial Instruments: Recognition and Measurement on Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk. The general objective of the amendment is to simplify the implementation of IAS 39 by enabling fair value hedge accounting for a portfolio hedge of interest rate risk. The amended standard completes the "stable platform", i.e. the set of standards which listed companies have to apply in their consolidated accounts from 1 January 2005 onwards.

(4) IAS 39 in its present form meets the conditions for adoption set out in Article 3(2) of Regulation (EC) No 1606/2002, with the exception of certain provisions relating to hedge accounting, which are an obstacle to allow portfolio hedging of core deposits on a fair value measurement basis. Those provisions are clearly distinct and separable from other parts of the standards.

(5) On hedge accounting, IAS 39 does not sufficiently take into account the way in which many European banks operate their asset/liability management particularly in a fixed interest rate environment. The limitation of hedges to either cash flow hedges or fair value hedges and the strict requirements concerning the effectiveness of those hedges make it impossible for those banks to hedge their core deposits on a portfolio basis and would force them to carry out important and costly changes both to their asset/liability management and to their accounting system. Enabling portfolio hedging of core deposits on a fair value measurement basis is consistent with the principle stated in the standard that the fair value of a financial liability with a demand feature cannot be less than the amount payable on demand since this principle does not cover portfolios. Due to internal interactions and the law of large numbers, a portfolio hedge is different from the hedge of a single asset or a single liability. This matter has been recognised as a significant issue by the IASB which has announced the creation as a matter of priority of a working group which will examine proposals made by European banks for the introduction into IAS 39 of a hedge accounting method (interest margin hedge) which would more closely reflect the way in which these banks conduct their asset/liability management.

(6) Those provisions of IAS 39, which prevent portfolio hedging of core deposits on a fair value measurement basis, and which can be clearly identified, should not be adopted because they do not meet the conditions set out in Article 3(2) of Regulation (EC) No 1606/2002 and in particular the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions.

(7) IAS 39 introduces an option to fair value all financial assets and liabilities. However, the IASB has recently published an Exposure Draft (a consultation paper) which proposes an amendment to IAS 39 in order to restrict the fair value option contained in the standard. The proposed amendment is a direct response to concerns expressed by the European Central Bank, by prudential supervisors as well as by securities regulators which fear that the fair value option might be used inappropriately. This proposed amendment is currently debated in public and a final version will most likely not be available before the end of 2004.

(8) The provisions in IAS 39 relating to that fair value option, which are also distinct and separable from other parts of the standard, should not be considered applicable, because of the uncertainty surrounding the final version of those provisions. As soon as the IASB has completed its work on this issue, and normally no later than by the end of 2005, the Commission will examine the resulting amendments to IAS 39 with a view to their endorsement, in the light of the conditions set out in Article 3(2) of Regulation (EC) No 1606/2002.

(9) It is the clear objective to arrive as soon as possible –and normally no later than the end of 2005- at a situation whereby an amended IAS 39 can be adopted in full. The adoption of appropriate provisions on hedge accounting in the near future is linked to the progress made by the working group set up by the IASB. Accordingly, the Commission will monitor closely the work of the IASB in this area and the applicability of the standard should therefore be reviewed regularly by the Commission.

(10) Companies which prepare for the first time their financial statements in accordance with international financial reporting standards (IFRS) and apply IAS 39 in the version annexed to this Regulation are “first time adopters” within the meaning of IFRS 1, as adopted by Regulation (EC) No 707/2004.

(11) The adoption of IAS 39 implies, by way of consequence, amendments to IAS Nos 12, 18, 19, 30, 36 and 37, and SIC 37, which were adopted by Commission Regulation (EC) No 1725/2003, in order to ensure consistency between the accounting standards concerned.

(12) Regulation (EC) No 1725/2003 should therefore be amended accordingly.

(13) The measures provided for in this Regulation are in accordance with the opinion of the Accounting Regulatory Committee,

HAS ADOPTED THIS REGULATION:

#### *Article 1*

1. International Accounting Standard (IAS) 39 *Financial Instruments: Recognition and Measurement*, with the exception of its provisions on the use of the fair value option and certain of its provisions relating to hedge accounting, is inserted in the Annex to Regulation (EC) No 1725/2003.

The text for insertion, as referred to in the first subparagraph, is set out in the Annex to this Regulation.

2. IAS Nos 12, 18, 19, 30, 36 and 37 and SIC-27 as well as International Financial Reporting Standard 1 are amended in accordance with Appendix B of IAS 39, as set out in the Annex to this Regulation.

#### *Article 2*

The Commission shall review the applicability of IAS 39 *Financial Instruments: Recognition and Measurement* once the provisions relating to the fair value option and the hedge accounting have been amended by the IASB or at the latest by 31 December 2005.

#### *Article 3*

This Regulation shall enter into force on the twentieth day following that of its publication in the Official Journal of the European Union.

It shall apply from 1 January 2005 at the latest.

Done at Brussels, [...]

*For the Commission*  
Frederik BOLKESTEIN  
*Member of the Commission*

ANNEX

<b>INTERNATIONAL ACCOUNTING STANDARDS</b>	
<b>IAS No</b>	<b>Title</b>
IAS 39	<i>Financial Instruments: Recognition and Measurement</i> <b>with the exception of the provisions on the use of the fair value option and certain provisions relating to hedge accounting</b>

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