

SUMMARY RECORD

MEETING OF
THE ACCOUNTING REGULATORY COMMITTEE
OF 1 OCTOBER 2004

M. Schaub, Director General of DG Internal Market chaired the eleventh committee meeting as for the vote and the discussions on the draft regulation on IAS 39 (agenda item 2). M. Wright, Director for Financial Markets, DG Internal Market, chaired the remaining parts of the meeting.

1. VOTE ON IAS 39

Result of the vote on a Proposal for a Commission Regulation adopting IAS 39 *Financial Instruments: Recognition and Measurement* with the exception of certain provisions on the use of the fair value option and certain provisions relating to hedge accounting, in accordance with Regulation (EC) N° 1606/2002 of the European Parliament and of the Council

A qualified majority of the Member States represented (=92 votes) in the Accounting Regulatory Committee voted in favour of the draft Commission Regulation proposing the endorsement of IAS 39 *Financial Instruments: Recognition and Measurement* with the exception of certain provisions on the use of the fair value option and certain provisions relating to hedge accounting. Three Member States (=15 votes) abstained; four Member States (=17 votes) voted against the proposal

2. DISCUSSION

In his opening remarks the Chairman stated that:

- The partial adoption of IAS 39 represents an exceptional situation due to the inability of the main actors outside the Comitology procedure to co-operate sufficiently and in time.
- The partial adoption of IAS 39 is a temporary solution. On the basis of information received from the IASB Chairman, the Commission expects a final solution with the following timetable :

a) On the full fair value option – carve out number 1 –

Banking supervisors and the ECB oppose the current full fair value option contained in the present IAS 39. This stance has led the IASB to reconsider the fair value option, which led to an Exposure Draft issued in April 2004. Comment letters have been received by the IASB in September 2004. The Chairman of the IASB has declared that this issue will be dealt with as a matter of urgency and that he hopes for a final decision to be taken by the IASB in December 2004. Under these circumstances, the Commission would hope for a final adoption of a revised fair value option in April 2005.

b) On the portfolio hedging of core deposits – carve out no 2

The Commission urged both the IASB and the banking industry to intensify work to find an acceptable solution. The Commission expects that the working group between the IASB and European Banks will without delay examine the proposal for an interest rate margin hedge and will conclude its technical work in April 2005 to the Board. Accordingly, the IASB might be in a position to solve the issue of hedge accounting in autumn 2005. Based on that information, Commission expects to endorse revised IAS39 around the end of next year.

- Compared to the initial proposal, presented at the last ARC meeting of 8 September, the changes in the new proposal are as follows:

a. On the full fair value option – carve out number 1 –,

The justification based on procedural grounds is maintained whilst putting more emphasis on the legitimate concerns of the European Central Bank and the prudential supervisors represented in the Basel Committee. Companies are not allowed to apply the full fair value option and Member States are not allowed to introduce it either, as this would conflict with Article 42a of the Fourth Company Law Directive.

b. On the portfolio hedging of core deposits – carve out no 2

The relevant provisions are no longer rejected on grounds of substance, such as the criteria of understandability, relevance, reliability and comparability. Instead, it is considered that the provisions in question are not completed nor ready for an agreement

- c. IFRS 1: In addition, the problem of the “first time adopters” will be dealt with in the Regulation itself (Article 1 (2) and not only in a recital so as to provide for more legal certainty for companies and auditors.

3. EXPLANATORY MEMORANDUM

The Chairman summarised the Explanatory Memorandum of the Commission Services as follows:

- A partial endorsement is legally possible as far as a standard deals with accounting subjects which are entirely autonomous, distinct and separable.
- In the present case, two carve outs are envisaged which are limited to what is strictly necessary and which do not make other provisions of IAS 39 meaningless.
- The full fair value option is distinct and separable since it was added into the already existing IAS 39 in December 2003. In addition, such an **option** granted to a company under an accounting standard is by nature separable from the mandatory part.
- On portfolio hedge of core deposits, a specific accounting issue has been addressed and the technical feasibility of the carve out proposed, has been assessed by EFRAG which considers this to be workable.

4. DECLARATION

The Chairman also invited Member States to consider supporting the vote on the draft regulation by an additional political declaration recalling the exceptional situation in which the Commission and Member States currently are and outlining when a final solution on the carved out provisions could be found. As one Member State declared not

being willing to sign up to the declaration, the Chairman concluded that only the Commission will present a declaration when the Regulation is adopted by the Commission.

5. QUESTIONS FROM MEMBER STATES

Responding to questions from Member States, the Chairman explained that:

- As Article 42a of the Fourth Company Law Directive is mandatory, there is no contradiction with the principles laid down in IAS 8, para.10 according to which the management has, in the absence of any specific standard, to adopt the appropriate accounting policy. Companies have to respect the Directive in this respect.
- The Commission will further consider the problems for insurance companies. The Insurance Accounting Directive offers a way out for unit linked contracts in the insurance sector, as set out in the Explanatory Memorandum.
- Companies can apply the provisions on hedge accounting under IAS 39 which have been carved out. As explained in the Explanatory Memorandum Member States may also require companies to respect the provisions on hedge accounting, which have been carved out;
- As for the acceptance of IAS 39 with the envisaged two carved outs by the US-SEC, the Chairman pointed out that he intends raising the issue in the US. In practice, this should not be an issue as US-GAAP currently does not have a full fair value option and as a European company listed in the US is also entitled to apply the carved-out provisions on hedge accounting.
- Companies would have to make clear in their financial statements and in their accounting policies that they are in full compliance with IAS as adopted by the European Union. On this basis, an auditor can provide an unqualified opinion.
- The Commission will closely follow the progress being made in the working group set up by the IASB in respect of the proposal on the interest rate margin hedge.

6. POSITIONS OF THE MEMBER STATES

Whilst 18 Member States supported the Commission proposal; four Member States opposed it and three Member States abstained. Member States not supporting the Commission proposal gave the following reasons:

- The partial endorsement is not covered by the spirit of the IAS Regulation. Only full endorsement would have been the right way forward;
- Limiting the carve out of the full fair value option to liabilities whilst not tackling the asset side might induce higher volatility. Only full IAS 39 is the right answer to the mismatch problem resulting from a mixed accounting model.
- The partial endorsement is setting an unfortunate precedent for future cases, which should be avoided.

Member States supporting the Commission proposal stressed the need to go forward and to present a solution which accommodates the needs of companies and financial markets. A number of Member States mentioned the fact, that the solution presented by the Commission is only their second choice. However, given the current problems in respect of the full standard, it seems to be the only alternative possible for the time being.

In the course of the discussions, two aspects were discussed and the recitals to the draft regulation adapted in the light of the discussions:

- Following requests from two Member States, it was agreed to clarify in a recital that in the case of financial assets that are not traded in active and liquid markets, companies should take care to apply the fair value option to financial assets in a way that leads to reliable measurement (Recital 5);
- Following a request from another Member State, it was agreed to lay down in recital 10 the principle that companies may apply the provisions carved out as regards hedge accounting.

The Chairman thanked Member States for the support and promised to keep Member States posted. The Commission will continue to contribute actively to the current talks between IASB and banks in order to find solutions for the two carve outs.

7. OTHER AGENDA POINTS

Agenda item 1 – Approval of the minutes of the ARC meeting of 9 July 2004

Due to time constraints, it was decided by the Commission to approve the minutes either at the next meeting or in written procedure.

Agenda item 3 – First draft of a Proposal for a Directive amending the Accounting Directives

The Chairman outlined the intention of the new proposal which build on the Company Law Action Plan of May 2003 and a consultation in spring 2004 as follows:

- the draft proposal intends to confirm the collective responsibility of board members for ensuring that financial statements are drawn up according to the requirements of Directives.
- aligning the Accounting Directives even further with IAS by applying the IAS-definitions of related parties to also unlisted companies. However the disclosure would be limited to unusual transactions with related parties, i.e. not carried out at arm's length. Thus, the disclosure requirements would be more limited compared to those applicable to listed companies under IAS 24.
- clarifying that companies must provide information about the nature, business purpose and financial impact of material off-balance sheet arrangements. This should also capture special purpose vehicles which do not already appear in the consolidated accounts.
- proposing that listed companies must publish a corporate governance statement as a part of their annual report – using the “comply-or-explain” method, as already foreseen in some Member States on a voluntary basis.

Member States expressed their general support for the Commission proposal, expressing the need to do some fine-tuning. The Chairman requested Member States to send in their written comments by 8 October 2004.

The Chairman announced that the next ARC meeting would take place on 30 November.

ACCOUNTING REGULATORY COMMITTEE
Meeting of 1 October 2004

PARTICIPANTS' LIST

Austria

Justizministerium

Finanzministerium

Finanzmarktaufsicht

Belgium

Commission des Normes Comptables

Fod. Economie

Cyprus

Permanent Representation

Czech

Ministry of Finance

Denmark

Ministry of Economic

Danish FSA

Danish Commerce and Companies Agency

Estonia

Estonian Accounting Standards Board

France

Conseil National de la Comptabilité (CNC)

Ministère de l'Economie, des Finances et de l'Industrie (Trésor)

SGCI/Premier Ministre

Finland

Ministry of Finance

Ministry of Trade and Industry

Germany

Bundesministerium der Justiz

Bundesministerium für Wirtschaft und Arbeit

Greece

Ministry of Economy and Finance

S.O.E.L.

Hungary

Ministry of Finance

Financial Supervisory Authority

Ireland

Institute of Chartered Accountants in Ireland

Dept. Of Enterprise, Trade and Employment

Italy

CONSOB

ISVAP

Ministry of Economy and Finance

Banca d'Italia

Latvia

Ministry of Finance

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Lithuania

Ministry of Finance

Accounting Institute

Luxembourg

Commission de Surveillance du Secteur Financier

Ministère de la Justice

Malta

Accounting Standards Board

The Netherlands

**Ministerie van Justitie
Ministry of Finance**

Poland

Ministry of Finance

Portugal

**CMVM
Permanent Representation**

Slovakia

**Ministry of Finance
Permanent Representation**

Slovenia

**Ministry of Finance
Slovenian Institute of Auditors**

Spain

**Banco de España
ICAC**

Sweden

Ministry of Justice

United Kingdom

**Department of Trade and Industry
Permanent Representation**

OBSERVERS

EFTA

Iceland

Ministry of Finance

European Institutions/Committees

European Central Bank (ECB)

Committee of European Banking Supervisors (CEBS)

Committee of European Securities Regulatory (CESR)

Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS)

European Financial Reporting Advisory Group (EFRAG)

Commission

**Alexander Schaub, Director General of the DG Internal market,
Chairman of the ARC on agenda point 2**

**David Wright, Director "Financial markets", Chairman of the
ARC on agenda point 3**

Karel Van Hulle, Head of Unit "Accounting & Auditing",

Jürgen Tiedje, Secretary to the ARC/ G5

Arto Leppilahti/G5

Thomas Scholz/G5

Lars Vind Sorensen/G5

Ulf Linder/ F3

Mike Thoms/ F3

Allister Wilson, Adviser to the European Commission