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EU Accounting Regulatory Committee supports Commission proposal to endorse the amended "IAS 39 Fair Value Option"

On July 8, 2005, the Accounting Regulatory Committee (ARC), which advises the European Commission on the endorsement of individual International Financial Reporting Standards (IFRS) for use in the European Union, agreed unanimously to recommend endorsement of an amended version of IAS 39 relating to the Fair Value Option ("FVO") previously carved out. It is expected that the Commission will adopt the amended standard as soon as possible. Adoption will be retroactive to January 1, 2005, so that companies will be able to apply the amended standard for their 2005 financial statements.

The Fair Value Option or FVO introduced into IAS 39 in 2004 allowed entities to designate irrevocably on initial recognition *any* financial instruments as ones to be measured at fair value with gains and losses recognised in profit or loss. The purpose of the option was to simplify the application of the standard.

On November 19, 2004, the European Commission adopted a Regulation endorsing IAS 39, with the exception of two "carve-outs". The first carve-out related to certain provisions on the use of the full FVO; the second to certain provisions on hedge accounting. The Commission carved-out those provisions because of concerns of the European Central Bank and prudential banking supervisors.

After extensive consultation with third parties, on June 16, 2005, the IASB published an amended version of IAS 39 by limiting the use of the FVO to those financial instruments that meet certain conditions.

Those conditions may be summarized as follows:

Upon initial recognition a financial asset or a financial liability may be designated by the entity as at fair value through profit or loss. An entity may use this designation only in the following situations :

1. If a contract contains one or more embedded derivatives, an entity may designate the entire hybrid (combined) contract as a financial asset or financial liability at fair value through profit or loss (there are some exceptions to this – see IAS 39.11A revised), or

2. When doing so results in more relevant information, because either
  - (i) the entity eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as ‘an accounting mismatch’) that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
  - (ii) a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity’s key management.

The Accounting Regulatory Committee (ARC) agreed on July 8, 2005 to recommend endorsement of this amended FVO by the Commission. The Commission intends now to adopt rapidly the amended FVO.

The new FVO is applicable for annual periods beginning on or after January 1, 2006, early adoption is encouraged. As a result, adoption should be possible in the EU for annual periods beginning on or after January 1, 2005.

Once this new FVO will be adopted by the EU, first-time adoptors will need to react quickly if they intend to implement the revised FVO for 2005.

If you have any queries regarding this Flash, please do not hesitate to contact one of the following IFRS specialists:

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