Report to
G7 Finance Ministers and Central Bank Governors
on
International Accounting Standards

Basel Committee on Banking Supervision

Basel
April 2000

Table of Contents

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Executive Summary

This report to the G7 Finance Ministers and Central Bank Governors (G7 Ministers) presents the findings and conclusions of the Basel Committee (the Committee) on its review of the International Accounting Standards Committee's (IASC) accounting standards. This review was undertaken at the request of the G7 Ministers. The Committee's Task Force on Accounting Issues (the Task Force) performed much of the actual review work. The Committee limited its review to the 15 international accounting standards (IASs) that have a significant effect on banks.[1]

From a banking supervisory standpoint, which is the context within which the Task Force performed its review, no significant concerns were found in seven of the IASC standards. With two exceptions, the Committee identified only a few issues of supervisory concern in the other standards it reviewed. First, the Committee believes that IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* needs updating. Second, the Committee had a number of significant initial concerns in relation to IAS 39 *Financial Instruments: Recognition and Measurement*. The Committee has discussed its initial concerns about IAS 39 with the IASC in a joint working group of IASC and Basel Committee representatives established by the IASC to consider the Committee's concerns. The joint working group has also had discussions with representatives of banking organisations.

The concerns identified with respect to IAS 30 relate primarily to the standard not having been updated since 1991 to encompass current best practice in terms of disclosure of risk exposures and risk management policies. The Committee advised the IASC that IAS 30 should be revised to reflect these developments. As a result, the IASC has added a project to

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1 Accordingly, the Committee has not concluded on the acceptability of all IASC standards or for all purposes.

its agenda that will consider the need to revise this standard and it plans to establish the Steering Committee for this project in June 2000.

IAS 39 – issued in early 1999, with an implementation date of 1 January 2001 – significantly increases the use of fair values in accounting for financial instruments, compared to both the existing international accounting standards and most countries' national standards. Under today's system of accounting for each main area of a bank's activities, often described as "banking" and "trading" books, the banking book is usually measured at amortised cost and the trading book at fair value in most countries. To achieve consistent reporting of profits and losses, derivatives used as hedging instruments are accounted for in the same manner as the item hedged: that is, at historical cost where they hedge banking book items and at fair value when they hedge trading items. In contrast, under IAS 39, financial assets will generally be categorised as being held for trading, available for sale or held to maturity. Assets held for trading and assets available for sale, such as purchased loans and certain debt and equity securities, will be carried at fair value, while held to maturity assets and originated loans – and most financial liabilities – will be carried at amortised cost. All derivatives, whether held for trading or for hedging, will be accounted for at fair value.

Thus, the provisions of IAS 39 may have a major impact on how banks account for financial risks that are hedged. The standard's piecemeal approach of reporting most liabilities at cost, while introducing more fair value accounting on the asset side of the balance sheet, is likely to increase the risk of volatility in reported earnings and equity that may not reflect banks' underlying risk management practices, for example, in the case of matched asset and liability positions. In addition, IAS 39's requirement that all derivatives are to be carried at fair value will change the present accounting for banking book hedging strategies that use derivatives.

The Committee recognises the importance of banks managing their overall risk profile. Many internationally active banks currently use hedges to adjust their overall net exposure in the banking book on a dynamic basis, and use internal transactions to reallocate risk exposures from the banking book to the trading book. Accounting standards should contribute to sound risk management practices. Thus, it would be of concern to the Committee if the restrictive nature of the hedging provisions of IAS 39 encouraged banks to move away from meeting the principles for best practice global risk management. The joint IASC/Basel working group has discussed these hedging issues and approaches have been suggested which would permit banks to use the IAS 39 hedge accounting framework in ways that are more consistent with their portfolio-based risk management practices.

In many countries, IAS 39's introduction of a new basis of measurement for certain types of financial instruments – fair value – will raise a wide range of practical implementation issues. In the absence of active markets, there will be difficulties in obtaining or calculating reliable fair values for certain non-marketable financial instruments previously held at cost. The Committee believes that the IASC needs to provide considerable guidance on the measurement of fair value in these circumstances, which will also enhance the auditability of fair value estimates. The Committee further believes that significant interpretive and implementation guidance is necessary before companies will be able to comply with IAS 39. The joint IASC/Basel working group established to discuss the Committee's concerns has served as a useful forum for clarifying and understanding these issues. The Secretary General of the IASC agrees on the need for interpretive guidance and the IASC has created an IAS 39 Implementation Guidance Committee. The work of this IASC committee should be concluded, and the necessary guidance issued, as soon as practicable, and before the standard comes into force. The IASC should carefully consider the extent to which the need for timely guidance affects the ability to implement all parts of IAS 39.

Although IAS 39 significantly extends the use of fair values in accounting for financial instruments and has not yet taken effect, the IASC and other standard setters are currently working together to develop a comprehensive standard on full fair value accounting for financial instruments in the primary financial statements. Because the introduction of fair value information into the financial statements outside the trading book is relatively new in most countries, the Committee is studying the implications of full fair value accounting – both for banking institutions and for the supervisory regime. In particular, the Committee's study is considering the relevance of applying fair value accounting to banking book financial instruments as well as its effect on banks' risk management practices and on the measurement of banks' capital adequacy. Another key issue in relation to fair values is the reliability of their measurement.

Thus, there is uncertainty as to the benefits of fair value accounting and a lack of guidance in determining fair values. As a result, the Committee does not believe that the time is right to prescribe full fair value accounting in the primary financial statements for all financial instruments. The disclosure of fair value information in respect of financial instruments may be a useful addition to assist preparers and readers of financial statements. Information on the extent to which the IASC’s existing fair value disclosure standard (and similar national standards) is being complied with would be helpful in assessing whether more complete disclosure of fair value based financial statements is sufficient for the purposes of giving fair value information to investors and whether further steps toward fair value accounting in the primary financial statement are actually necessary.

The banking sector will be the most affected by the provisions of IAS 39 and any standard on full fair value accounting that may result from the efforts of the IASC and other standard setters. To ensure that banks provide input on the many practical issues relating to accounting for financial instruments, the Committee believes that accounting standard setters and banks must engage in a continuing, substantive and timely dialogue to discuss these issues in detail. The Committee is encouraged by the constructive dialogue that is emerging between the IASC and representatives of banking associations which, at the Committee’s suggestion, was initiated by the joint IASC/Basel working group. Moreover, it is vital that the IASC's due process is effective and is seen to be followed in practice. Only if all relevant stakeholders in the international standard setting process feel committed to, and part of, the process will the output of the IASC be widely accepted.

On this basis, the Committee expresses its support for the standards developed by the IASC. It will continue a close dialogue with the IASC and the banking industry to monitor future developments with care.

I. Introduction

1. The International Accounting Standards Committee (IASC) and the International Organisation of Securities Commissions (IOSCO) agreed in 1995 on a programme of work to prepare a set of accounting standards that could be accepted internationally. In accordance with the programme, the IASC completed an agreed set of standards at the end of 1998.

2. In their Declaration of 30th October 1998, G7 Finance Ministers and Central Bank Governors requested IOSCO, the International Association of Insurance Supervisors (IAIS) and the Basel Committee (the Committee) to carry out a timely review of IASC's standards.

"[S]tandards of transparency are required in the private sector. We call upon … the IASC to finalise by early 1999 a proposal for a full range of internationally agreed accounting standards. IOSCO, IAIS and the Basel Committee should complete a timely review of these standards" [Paragraph 7(ii) of the Declaration]

3. In two of the G7 countries, the IASC's standards are permitted to be used for group accounts without reconciliation to national accounting requirements. At least one other G7 country allows overseas companies to list on their stock exchange using these standards, again without reconciliation. The IASC standards are widely used in emerging countries and countries in transition, sometimes in place of national standards, and sometimes through national standards being the same as the IASC standards.

4. This report constitutes the Committee's report on its review of IASC's accounting standards,[2] as mandated in October 1998, and contains the Committee's findings and conclusions following that review. As the Committee's primary expertise relates to the supervision of banking organisations, the Committee has reviewed the standards from the perspective of banking supervisors, and has limited its review to those standards that have a significant effect on banks. Accordingly, the Committee has not concluded on the acceptability of all IASC standards or for all purposes.

5. The report considers the interests of banking supervisors in accounting generally and sets out the background to the Committee's review of the IASC's package of accounting standards **(Section II).** The report next discusses the criteria that were adopted as the basis for the Committee's review, and describes the work and process which were followed **(Sections III and IV).** Finally, the report sets out the Committee's findings and conclusions **(Section V)**, followed by its summary observations **(Section VI).**

6. A set of accounting standards can never be complete. New standards will be developed, and amendments will be made to existing ones. The Committee will therefore

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[2] As well as published International Accounting Standards (IASs), the Committee has also reviewed relevant consensuses prepared by the IASC's Standing Interpretations Committee (SIC). The IASC created the SIC in 1997 to consider, on a timely basis, accounting issues likely to receive divergent or unacceptable treatment in the absence of authoritative interpretation. In this report, the word 'standards' and the abbreviation 'IASs' are used to encompass both sets of documents.

continue to examine and, when appropriate, comment on any new or amended IASC standards. The Committee believes that the IASC needs to be vigilant to ensure that its structure and the due process followed in developing standards - including the current reform of its constitution - is transparent and effective. The Committee comments on the importance of this in paragraphs 51 to 54 below. In addition, the Committee is currently studying the implications of full fair value accounting for financial instruments (see paragraph 48 below).

7. As mentioned in paragraph 2 above, IOSCO and the IAIS have also been requested to review the IASC's standards. The Committee has maintained liaison with IOSCO and the IAIS in this review.

II. Interests of banking supervisors

(a) Importance of high quality accounting standards and international accounting harmonisation

8. Banking supervisors have an interest in the quality of accounting standards and their effective implementation, as a means of providing a basis for relevant and reliable measures of assets, liabilities, equity and income, as well as capital adequacy, and enhancing market discipline through transparent financial reporting. They want to ensure that accounting standards used by banks both support these goals and facilitate - rather than work against - supervisors' objective of fostering safe and sound banking systems.

9. The growing interdependence of international financial and banking markets necessitates accurate and transparent published financial statements that are consistent and comparable. It is important that such financial statements be based on high quality accounting standards that result in transparent financial information. The Committee strongly supports efforts to harmonise accounting practice internationally. From a banking supervisory perspective, international accounting harmonisation could potentially strengthen - and make more transparent - the link between measurement standards and public reporting and prudential requirements. The policy releases and proposals discussed below reflect the perspective of the Basel Committee on sound accounting and disclosure practices.

(b) Basel Committee Publications

10. Committee has in recent years published a number of papers and guidance notes which include recommendations on accounting and disclosure. These are described in more detail in Annex I, but comprise the following:

- The Basel Core Principles for Effective Banking Supervision: September 1997
- Enhancing Bank Transparency: September 1998
- Sound Practices for Loan Accounting and Disclosure: July 1999
- Best Practices for Credit Risk Disclosure: consultative paper, July 1999
- Recommendations for Public Disclosure of Trading and Derivatives Activities of Banks and Securities Firms: October 1999

(c) Capital adequacy measurement

11. In addition to the guidance mentioned above that directly addresses bank accounting and disclosure topics, the Committee has stated that market discipline has an important role in its proposed new capital framework. This is presented in the proposals to amend the Basel Capital Accord of 1988, published in a Consultative Paper in June 1999 - *A New Capital Adequacy Framework.* These proposals stress the need for banks to disclose information on their accounting policies, including policies for valuation of assets and liabilities, their risk management policies, their risk profiles and their capital components. This information is crucial to enable financial statement users to assess and compare the characteristics and adequacy of an institution's capital. The Consultative Paper also emphasises that supervisors have a strong interest in facilitating market discipline as a lever to strengthen the safety and soundness of the banking system. Market discipline requires reliable and timely information that enables market participants to make well-founded risk assessments.

12. The measurement of financial assets and liabilities is a particular concern of supervisors. There have been many developments in banks' risk measurement techniques and practices since the Basle Capital Accord was published in 1988, in particular in measuring and managing market risk and credit risk. The approach to measuring risk positions in each

main area of a bank's activities – often described as “trading” and “banking” books – is a matter of vital interest to supervisors. Measuring regulatory capital[3] appropriately needs to take account of the different risk and other attributes of trading and banking book assets and of off-balance sheet activities. In response to developments in standard setting, supervisors have to consider whether the appropriate measurement basis for financial instruments in the primary financial statements and for capital adequacy purposes is historical cost or some calculation of fair value[4], and whether the same measurement basis is appropriate for both trading and banking books.

13. It is well established that for capital adequacy purposes fair value is the appropriate measurement basis for the *trading book*. The Basel Accord allows banks to measure their trading books on a fair value basis for capital adequacy purposes.

14. In respect of the *banking book*, some banks are attempting systematically to classify exposures according to internal estimates of borrower (or facility) risk. Some banks are also attempting to develop credit risk models, which could offer a more precise basis for factoring expected loss into the valuation of non-traded assets. At present, the reliability of credit risk models is unproven, and the Committee is still evaluating these models for supervisory purposes.

15. Supervisors are developing a framework for using internal ratings developed by banks to determine regulatory capital requirements, including ways of promoting the accuracy, consistency and comparability of these internal estimates. It is probable that, to ensure comparability, banks will have to relate their grading systems to a common quantifiable concept, such as default probability or expected loss. If the revised Basel Accord, as currently proposed, enables banks to allocate regulatory capital against banking book risks on the basis of their own system of internal ratings, it is probable that more banks will consider developing this type of system. Clearly, these developments may in turn have implications for risk management and accounting, as well as for valuations in published financial statements.

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[3] There are some differences between the definition of the trading book for capital adequacy purposes and that often used for accounting purposes.

[4] For more discussion of fair value, see paragraphs 43 to 50 below.

III. Criteria for evaluating the standards

16. From a banking supervisory perspective, the Committee believes that accounting standards should satisfy three general criteria:

(i) Accounting standards should contribute to – or at least be consistent with (not hamper) – sound risk management and control practices in banks. As well, they should provide a prudent and reliable framework for the generation of high-quality accounting information in banks.

(ii) Accounting standards should facilitate market discipline by promoting transparent financial reporting of banks' financial position and performance, risk exposures and risk management activities.

(iii) Accounting standards should facilitate and not constrain the effective supervision of banks.

17. In addition to these general criteria, the Committee identified ten specific criteria against which it evaluated the standards. Many of these specific criteria are widely accepted internationally as underpinning high quality accounting standards:

(i) Accounting principles should generate relevant and meaningful accounting information.

(ii) Accounting principles should generate prudent and realistic measurements of financial position and performance.

(iii) Accounting principles should generate reliable[5] measurements of financial position and performance.

(iv) Accounting standards should not only have a sound theoretical foundation, but also be workable in practice.

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[5] As part of the 'reliability' criterion, the Committee believes that fair value information must be auditable.

(v) Accounting standards should not be overly complex in relation to the issue addressed.

(vi) Accounting principles should generate consistent measurements of similar or related items.

(vii) Accounting standards should be sufficiently precise to ensure consistent application.

(viii) Preferably, accounting standards should not allow alternative treatments. When alternative accounting treatments are permitted, or judgements are necessary in applying accounting principles, balanced disclosures should be required.

(ix) Disclosures should be sufficiently comprehensive for an assessment of a bank's financial position and performance, risk exposures and risk management activities.

(x) International Accounting Standards should be suitable for implementation not only in the most advanced financial markets but also in emerging markets.

18. Annex II to this paper elaborates on the Committee's views on these general and specific evaluation criteria.

IV. Work programme

19. The Committee's Task Force on Accounting Issues (the Task Force) developed an extensive work programme to determine the acceptability of IASs from the point of view of banking supervisors' objectives of prudent bank regulation and supervision and enhanced comparability and transparency. As noted in paragraph 4 above, the Task Force focused its review on the identification, analysis and assessment of issues that are of interest to banking supervisors, in particular, measurement and disclosure in bank financial statements. Accounting standards that primarily affect the usefulness of financial statements prepared by bank counterparties have generally not been considered.

20. The Task Force identified some 15 standards (listed in Annex III) covering measurement, consolidation, income recognition and disclosure in bank financial statements. The evaluation of these standards has been guided by the general and specific criteria outlined

above – the focus being on the importance of prudent, conservative, reliable, consistent and transparent accounting information.

21. In view of the importance of a sound standard setting process, the Committee also considered the due process followed by the IASC, and the proposals made by its Strategy Working Party for the IASC's future structure.

V. Findings and conclusions

(a) Overview

22. The principal findings in respect of the standards reviewed are set out in Annex IV. No issues of supervisory concern emerged on the seven standards listed in Part (a) of Annex IV.

23. In respect of most of the other standards the Committee has reviewed, from a supervisory perspective there are only a few issues of concern, which are set out in Part (b) of Annex IV. In particular, the Committee believes that IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* needs updating (see paragraphs 26 and 27 below). These matters have all been brought to the IASC’s attention and the IASC has taken certain actions in response to the Committee's concerns. The Committee had, however, a number of significant initial concerns in relation to IAS 39 *Financial Instruments: Recognition and Measurement,* which are described in paragraphs 28 to 42 below. The Committee's initial concerns in relation to IAS 39 have been discussed with the IASC in a joint working group of IASC and Basel representatives, which the IASC established to consider the Committee's concerns. The joint working group also had discussions with representatives of banking organisations.

24. The absence of any specific supervisory concern being recorded in respect of a particular standard should not be taken to mean that supervisors accept every aspect of that standard. Supervisors may still wish, for capital adequacy purposes, to make adjustments to accounting treatments prescribed for published financial statements. These adjustments can be dealt with within the arrangements for the measurement of regulatory capital. Existing circumstances in which supervisors may require adjustments to financial statements when measuring capital adequacy include:

- Deferred tax assets
- Intangible assets, including goodwill
- Loan loss allowances
- Subordinated debt
- Shares held in banks and financial institutions

25. Generally, the purposes of these adjustments are to arrive at a conservative measurement of a bank's capital position and to include in the calculation of capital, positions that may not be reflected in equity but give capital-like support. Although banking supervisors have the right to make adjustments to financial information for capital adequacy purposes, there is a general wish that, wherever possible, such adjustments will be limited.

(b) Disclosures in bank financial statements generally - IAS 30

(General evaluation criterion ii and specific evaluation criterion ix)

26. The IASC published IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* in 1990. IAS 30 is, however, relatively old and its provisions have not been updated since 1991. As a result, it does not, in the Committee's view, go far enough in recognising current best (or even good) practice in terms of disclosure, particularly in relation to risk exposures and risk management policies. It is silent on, or deals inadequately with, many of the developments over the last eight or nine years. These developments include issues and sound disclosure practices raised in the Basel Committee papers listed in paragraph 10 above and described in Annex I.

27. The Committee has indicated to the IASC that it believes IAS 30 should be revised. The IASC has added a project to its agenda that will consider the need to revise this standard, and the IASC Secretary General has confirmed that the IASC Board will be asked to approve the membership of the Steering Committee for this project at its meeting in June 2000.

(c) Particular issues on IAS 39[6]

28. IAS 39 *Financial Instruments: Recognition and Measurement* - issued in early 1999, with an implementation date of 1 January 2001 - significantly increases the use of fair values in accounting for financial instruments, compared to the existing body of international standards and the national standards in most countries. The IASC's aim in doing this has been, in part, to counter opportunities for abuses, such as selling assets with unrealised gains while continuing to hold those with unrealised losses, a practice that, in the IASC's view, the current system of accounting can produce (although in some jurisdictions there is a requirement to make provision for unrealised losses). The general thrust of IAS 39 is consistent with the broad direction the IASC Board has given to the Joint Working Group of Standard Setters (JWG)[7] for its longer term project to study further and develop proposals for the use of full fair value accounting for all financial assets and liabilities in the primary financial statements.

Effect on risk management and control practices

(General evaluation criteria i and ii and specific evaluation criterion ix)

29. IAS 39 will significantly change the way in which many financial assets, and some liabilities, are accounted for in most countries. For example, financial assets will generally be categorised as being held for trading, available for sale or held to maturity. Assets held for trading will be marked to market, with changes in market values reflected in the current profit and loss account. Available for sale assets, such as purchased loans and certain debt and equity securities will be marked to market, with changes in market value reflected, initially, in a bank's equity. Held to maturity assets and originated loans will be carried at amortised cost. All derivatives, regardless of their use by banks (whether for trading or for hedging) will be accounted for at fair value. Thus, the accounting treatment for a wide range of assets and derivatives will be affected by the provisions of IAS 39. IAS 39 might also have a major impact on how financial risks which are hedged are accounted for.

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6 The Committee raised many issues on the text of the exposure draft (E62) which preceded IAS 39. Some of these were addressed in the final text, but many remain of concern. In this paper the Committee focuses on its more significant concerns; the other points have, however, been taken up with the IASC.

7 The Joint Working Group of Standard Setters consists of representatives of nine national standard setters, together with the IASC.

30. Under IAS 39, most financial liabilities will be reported at cost. Reporting most liabilities at cost, while introducing more fair value accounting on the asset side of the balance sheet, is likely to increase the risk of volatility in reported earnings and equity that may not reflect the reporting bank's underlying risk management practices, for example, in the case of matched asset and liability positions.

Hedging activities

31. Under today's system of accounting, the banking book is usually measured at amortised cost and the trading book at market value or fair value. To achieve consistent reporting of profits and losses, derivatives used as hedging instruments are accounted for in the same manner as the item hedged: that is, at historical cost where they hedge banking book items and at fair value where they hedge trading items. IAS 39 uses – as do many national accounting standards - specific criteria as a precondition for hedge accounting: for instance, banks must identify the components of hedges at inception and demonstrate the effectiveness of the hedge on an ongoing basis. However, IAS 39's requirement that all derivatives are to be carried at fair value means that the present accounting permitted in respect of both banking book and held to maturity investments hedging strategies will have to change.

32. Many internationally active banks currently use hedge accounting on a "macro" or portfolio basis, as this is the way they manage their global risk exposures. For instance, one of the objectives of a bank's Asset and Liability Management (ALM) activities may be to hedge the overall net interest rate risk exposure in the banking book on a dynamic basis. The Committee recognises the importance of banks managing their overall risk profile. The restrictive nature of the hedging provisions of IAS 39 was discussed in the joint IASC/Basel working group referred to in paragraph 23 above. Approaches have been suggested during these discussions which would permit banks to use the IAS 39 hedge accounting framework in ways that are more consistent with their portfolio-based risk management practices.

Internal transactions

33. Banks use internal transactions to reallocate risk exposures between different books within the bank. For instance, a bank may carry out an internal swap to transfer an interest rate exposure in the banking book to the trading book to achieve a zero interest rate risk position in the banking book. In this case, value fluctuations that would not have been

recognised in the banking book, since this is measured at cost, are recognised and managed in the trading book instead. Although the bank could hedge its banking book through direct contracts with external counterparties instead of internally, this would increase transaction costs and might expose the bank to increased credit risk through having to deal with a wider range of counterparties.

34. IAS 39 eliminates the profit and loss effect of internal transactions (that is, transactions between the banking and trading books of a bank) in banks' published financial statements. This follows normal consolidation practice, where a group preparing financial statements is treated as a single entity and should not be able to generate apparent profits or losses through internal transactions. General accounting practice is for the financial statements only to reflect the effects of transactions with third parties.

35. Eliminating profits (or losses) on internal transactions requires banks to be able to distinguish those (of which there can be a considerable number) from external transactions through their accounting systems. The Committee recommendation that the IASC and the banks discuss the implications and practicalities of doing this began to take place during the joint IASC/Basel working group meetings. Although these discussions are continuing, the representatives of the Basel Committee, the IASC and the banking industry have been able to reach preliminary agreement on a number of issues associated with internal contracts, while recognising the importance of maintaining normal consolidation practices.

Overall effect on risk management

36. The provisions of IAS 39 may, therefore, lead some banks to make some changes in how they manage their risks. It would be of concern to the Committee if the accounting consequences of applying IAS 39 to their hedging strategies encouraged some banks to move away from meeting the principles for best practice global risk management which the Committee is trying to get banks to follow. Accounting standards should contribute to sound risk management practices. These should take account of the ways in which trading and banking books are actually managed. As mentioned in paragraph 32 above, the joint IASC/Basel working group is discussing how banks can implement IAS 39 in ways that are more consistent with their risk management practices.

Reliability and transparency -need for practical implementation guidance

(General evaluation criterion ii and specific evaluation criteria iv, vi and x)

37. In many countries, the provisions of IAS 39 will introduce a new basis of measurement for certain types of financial instruments and will raise a wide range of practical implementation issues. There are many questions as to how banks and other entities should apply its provisions, and whether in particular situations the resulting fair value measurements are likely to be sufficiently reliable. This applies both to the inclusion of these numbers in published financial statements, and their use by supervisors.

38. Fair value measurement issues particularly arise in relation to certain non-marketable assets (and liabilities) previously held at cost. In the absence of active markets, there will be difficulties in obtaining or calculating reliable fair values – and even where fair values appear to be estimable, in some countries the reliability of these will be suspect. This calls into question the auditability of these fair value numbers. The Committee believes that the IASC needs to provide considerable guidance on the measurement of fair value in these circumstances. Measurement guidance is also needed to enhance the auditability of fair value estimates.

39. In those countries whose national standards currently require, or are about to require, the use of fair value numbers for certain types of financial instruments in the primary financial statements, there is a considerable body of interpretive and guidance material issued by the standard setter. This material covers both general practical implementation issues and guidance on applying the provisions to specific more complex situations or instruments.

40. The Committee believes that significant interpretive and implementation guidance is necessary before companies will be able to comply with IAS 39. As mentioned in paragraph 23 above, the IASC has been responsive to the Committee's concerns in this regard through the establishment of a joint working group with representatives of the Basel Committee to discuss these issues. Also as a result of the Committee's recommendation, representatives of banking organisations have participated in meetings of the joint working group. The joint working group has served as a useful forum for clarifying and understanding the issues the Committee has raised. The Secretary General of the IASC has written to the Chairman of the Committee's Task Force on Accounting Issues noting the constructive nature of these meetings.

41. The Secretary General of the IASC agrees on the need for implementation guidance and reports that the IASC is moving ahead with plans to ensure this guidance is developed on a timely basis. In this regard, the IASC has established an Implementation Guidance Committee specially to develop and issue guidance on many of the issues which arise under IAS 39. This Implementation Guidance Committee is scheduled to meet for the first time in late April or early May 2000. The work of the Implementation Guidance Committee should be concluded, and the necessary guidance issued, as soon as is practicable, and before the standard comes into force. The Committee believes that, in the light of the above-mentioned issues associated with IAS 39, the IASC should consider carefully the extent to which the need for timely guidance affects the ability to implement all parts of the standard.

42. Strong, interactive and timely dialogue with banks should be a major factor in identifying and developing guidance on these issues.

(d) Relevance and reliability of the fair values of financial instruments in primary financial statements

(General evaluation criterion i and specific evaluation criteria i and iii)

43. As mentioned in paragraph 28 above, IAS 39 significantly extends the use of fair values in accounting for financial instruments. Standard setters (including the IASC) are working together through the JWG to develop a comprehensive standard on full fair value accounting for the primary financial statements.

44. The Committee has addressed the issue of fair value in response to earlier consultative material issued by the IASC on accounting for financial instruments. The Committee responded to the IASC's March 1997 Discussion Paper *Accounting for Financial Assets and Financial Liabilities*, and to its Exposure Draft E62 (issued in June 1998). The Committee's position, as stated in these letters, is that many banks do not (or are not yet in a position to) manage the totality of their risk exposures based on the accounting model lying behind the fair value proposal, although trading books are often marked to market. A number of banks do regard banking book activities as different from trading book activities – not just because the accounting is different but for fundamental business reasons, including a view that changes in the fair value are not clearly real changes in income or capital available to the enterprise. The Committee's main concerns are that too broad application of fair value

accounting, including many banking book assets, would be inappropriate at present and that the proposal's hedge accounting standard could be simplified in ways consistent with sound risk management practices.

45. There is clearly significant information value for users of bank financial statements when these statements disclose the fair values of financial assets and financial liabilities. In addition, in the context of best practice risk management, which the Committee is anxious that banks aspire to, some believe that fair value information is more relevant than historical cost information. However, some banks, banking associations and other users feel strongly that fair value information – at least in the primary financial statements – is not at all relevant (and may actually be misleading) for banking book financial assets and liabilities and for the assessment of related risks. The first IASC standard in respect of financial instruments, IAS 32 *Financial Instruments: Disclosure and Presentation*, issued in 1996, called for the supplemental disclosure of fair value amounts for financial instruments.

46. In some countries, banks and other companies are required under their national accounting standards to provide supplemental disclosure of the fair value of their financial instruments, including their loan portfolio, in the notes to the financial statements. Institutions that do provide supplemental fair value disclosures should disclose the methods adopted to determine the fair values and any significant assumptions used in their estimation, and are encouraged to discuss issues associated with the estimation of fair values.[8]

47. There is uncertainty as to the benefits of fair value accounting and there is a lack of guidance in determining fair values. Moreover, banking books and trading books are managed in significantly different ways. As a result, the Committee does not believe that the time is right to prescribe full fair value accounting in the primary financial statements for all financial assets and liabilities. As previously indicated in Committee comment letters to the IASC, the Committee continues to believe that disclosure requirements for major market participants could be expanded to include supplemental disclosure of fair value-based summary financial statements on a consolidated basis, along with additional quantitative and qualitative disclosures. The disclosure of fair value information in respect of financial instruments, as

[8] Some banks which include fair value information in the notes to their financial statements include cautionary comments on the reliability of these numbers.

already required under IAS 32, may be a useful addition to assist preparers to experiment with different presentations and to assist readers to gain a better understanding of the size and movements of the figures involved. Information on the extent to which IAS 32 (and similar national standards) is being complied with would be helpful in assessing whether more complete disclosure of fair value based financial statements - albeit, as the Committee has suggested above, in a more comprehensive way than prescribed in IAS 32 - is sufficient for the purposes of giving fair value information to investors and whether further steps towards fair value accounting in the primary financial statements are actually necessary.

48. The introduction of fair value information into the primary financial statements themselves outside the trading book is relatively new, and is not formally required in many jurisdictions. The Committee is therefore currently studying the implications of introducing full fair value accounting – both for banking institutions (in particular, the relevance of its application to banking book financial assets and liabilities and the implications for banks' risk management practices) and for the supervisory regime (in particular, the measurement of capital adequacy).

49. As well as the whole question of their relevance, one of the key issues in relation to fair values is the reliability of their measurement. While to some extent, fair value information may well be relevant, such numbers should only be used for capital adequacy purposes if they are sufficiently reliable. Alternative treatments can also cause difficulty for supervisors. For example, in many countries the choice between taking remeasurement gains to income or equity has a significant impact on the amount of profit available for distribution.

50. As part of the longer-term project referred to in paragraph 28 above, the JWG is working on many of the measurement problems which affect reliability. Some of the JWG's concerns on reliability are discussed in one of their papers *Financial Instruments – Issues Relating to Banks*, which they sent to an international group of banking associations on 31 August 1999 for comment. In early October 1999, this group of banking associations published their joint response to the JWG paper, along with a paper setting out their conceptual case for maintaining the present cost-based approach for measuring financial assets and liabilities in the banking book. These banking industry papers suggest that there is still a very considerable difference of view between the JWG and the banking industry on the respective relevance and reliability of historical cost accounting and fair values in the primary financial statements. These differences of view need to be discussed further, understood, and

resolved before it will be possible to envisage any real progress towards a full fair value standard being made.

(e) Due process

51. The Committee believes that it is vital that the IASC's due process is effective and is seen to be followed in practice. Part of this process is designed to ensure that those likely to be most affected by new proposals are carried along with them. This will involve having discussions with, and taking appropriate consideration of the views of, relevant interest groups, and ensuring that proposals involving significant change are properly field-tested before their introduction. The importance of this was acknowledged by the IASC in its strategy review paper *Shaping IASC for the Future,* published in December 1998.

52. The banking sector will be the most affected by the provisions of IAS 39 and any standard on full fair value accounting that may result from the JWG's efforts. The IASC therefore needs to ensure that banks provide input on the many practical issues relating to accounting for financial instruments. Given the radical nature of the standard setters' proposals on fair value accounting, there should be a continuing, substantive and timely dialogue between the IASC (and the JWG) and the banking industry on these matters. The Committee understands that there was some dialogue between the banking industry and the IASC in the development of IAS 39. At the final stages of the new standard's development, however, significant changes were made against a very tight timetable, which resulted in amendments being agreed by the IASC Board which had not been subject to appropriate consultation. The Committee does not regard this as a satisfactory way to finalise proposals which have a major impact on particular industry groups.

53. In the light of the considerable reservations being expressed by the banking sector over IAS 39, we believe that the dialogue that took place was not as extensive as might have been appropriate. It may be that standard setters were reluctant to consult the banks – it may also be the case that the banks did not press their case for high-level discussions with the IASC strongly enough. The Committee nevertheless believes that accounting standard setters and banks must engage in a constructive, professional dialogue to discuss these issues in detail. Further study of bank risk management approaches and related accounting issues is necessary before a long-term solution can be found. The Committee is encouraged by the

constructive dialogue that is emerging between the IASC and representatives of banking associations which, at the Committee's suggestion, was initiated by the joint IASC/Basel working group referred to in paragraph 23.

54. Part of the due process problem is reflected in the current structure of the IASC itself. The IASC is aware that, in the light of recent and likely future developments in standard setting internationally, it is at a crossroads. At its meeting in November 1999, the IASC Board approved the key points of a new structure for the IASC, subject to the appropriate changes being made to the IASC constitution. The details of this structure were approved at its meeting in December 1999. It is important that the implementation of the new structure of the IASC gives all relevant stakeholders in the international standard setting process - including the banking industry and the Committee - the opportunity to contribute to this work, as appropriate. It is only if all parties feel committed to, and part of, the standard setting process that the output of the IASC will be widely accepted.

VI. Summary observations

55. The Committee's summary observations are as follows:

General

(i) On many of the standards reviewed, no issues of supervisory concern arise. The absence of any specific concern being recorded in respect of a particular standard should not be taken to mean that every aspect of that standard is accepted by supervisors. Supervisors may still wish, for capital adequacy purposes, to make adjustments to accounting treatments prescribed for published financial statements. **[paras 22 - 25]**

Disclosures by banks

(ii) IAS 30 does not go far enough in recognising current best practice in terms of disclosure, particularly in relation to risk exposures and risk management policies. It is an old standard and should be updated. The Committee notes that the IASC has added this project to its agenda, and that it proposes to establish a Steering Committee in June 2000. **[paras 26-27]**

IAS 39

(iii) The piecemeal approach of reporting most liabilities at cost, while introducing more fair value accounting on the asset side, is likely to increase the risk of volatility in reported earnings and equity that may not reflect the reporting bank's underlying risk management practices, for example, in the case of matched asset and liability positions. **[para 30]**

(iv) The Committee recognises the importance of banks managing their overall risk profile. The restrictive nature of the hedging provisions of IAS 39 was discussed in a joint IASC/Basel working group which the IASC established to consider the Committee's initial concerns about IAS 39, and approaches have been suggested that may interpret IAS 39 in a manner more consistent with portfolio-based risk management practices. **[para 32]**

(v) Eliminating profits (or losses) on internal transactions requires banks to be able to distinguish these from external transactions through their accounting systems. The IASC and the banks have begun to discuss the implications and practicalities of doing this. The joint IASC/Basel working group and banking industry representatives have been able to reach preliminary agreement on a number of issues in this area. **[para 35]**

(vi) It would be of concern to the Committee if the accounting consequences of applying IAS 39 to their hedging strategies encouraged banks to move away from meeting the principles for best practice global risk management which the Committee is trying to get banks to follow. Accounting standards should contribute to sound risk management practices. These should take account of the ways in which trading and banking books are actually managed. The joint IASC/Basel working group is discussing how banks can implement IAS 39 in ways that are more consistent with their risk management practices. **[para 36]**

(vii) In the absence of active markets, there will be difficulties in obtaining or calculating reliable fair values – and even where fair values appear to be estimable, in some countries the reliability of these will be suspect. Guidance on the measurement of fair value in these circumstances is needed, which will also enhance the auditability of fair value estimates. **[para 38]**

(viii) The Committee believes that significant interpretive and implementation guidance is necessary before companies will be able to comply with IAS 39. The IASC has been responsive to the Committee's concerns in this regard through the establishment of a joint IASC/Basel working group to discuss these issues. Also as a result of the Committee's recommendation, representatives of banking organisations have participated in meetings of the joint working group. The joint working group has served as a useful forum for clarifying and understanding the issues the Committee has raised. The Secretary General of the IASC has written to the Chairman of the Committee's Task Force on Accounting Issues noting the constructive nature of these meetings. **[para 40]**

(ix) The Secretary General of the IASC agrees on the need for implementation guidance, and reports that the IASC is moving ahead with plans to ensure this guidance is developed on a timely basis. In this regard, the IASC has established an Implementation Guidance Committee specially to develop and issue guidance on many of the issues which arise under IAS 39. The work of the Implementation Guidance Committee should be concluded, and the necessary guidance issued, as soon as is practicable, and before the standard comes into force. The Committee believes that the IASC should consider carefully the extent to which the need for timely guidance affects the ability to implement all parts of the standard. **[para 41]**

Full fair value accounting

(x) With regard to the IASC's joint project with other standard setters to develop a comprehensive standard on full fair value accounting for financial instruments, the Committee does not believe the time is right to prescribe full fair value accounting in the primary financial statements for all financial assets and liabilities. **[para 47]**

(xi) The disclosure of fair value information in respect of financial instruments may be a useful addition to assist preparers to experiment with different presentations and to assist readers to gain a better understanding of the size and movements of the figures involved. Information on the extent to which IAS 32 (and similar national standards) is being complied with would be helpful in assessing whether more complete disclosure of fair value based financial statements is sufficient for the purposes of giving fair value information to investors and whether further steps towards fair value accounting in the primary financial statements are actually necessary. **[para 47]**

(xii) The introduction of fair value information into the primary financial statements themselves outside the trading book is relatively new, and is not formally required in many jurisdictions. The Committee is therefore currently studying the implications of introducing full fair value accounting for banking institutions and for the supervisory regime. **[para 48]**

(xiii) Fair value information should only be used for capital adequacy purposes if it is sufficiently reliable. Alternative treatments can also cause difficulties for supervisors. For example, in many countries the choice between taking remeasurement gains to income or equity has a significant impact on the amount of profit available for distribution **[para 49]**

(xiv) There is still a very considerable difference of view between the JWG and the banking industry on the respective relevance and reliability of historical cost accounting and fair values in the primary financial statements. These differences of view need to be discussed further, understood and resolved before it will be possible to envisage any real progress towards a full fair value standard being made. Further study of bank risk management approaches and related accounting issues is necessary before a long term solution can be found. The Committee is encouraged by the constructive dialogue that is emerging between the IASC and representatives of banking associations which, at the Committee’s request, took place in the joint IASC/Basel working group. **[paras 50 and 53]**

Dialogue with banks

(xv) The standard setters' proposals on fair value accounting are radical in nature. The banking sector will be the most affected by any standard on full fair value accounting, as they are by the provisions of IAS 39. The IASC needs to ensure that both they and the JWG have a continuing, substantive and timely dialogue with the banking industry. The banks should provide input on the many practical issues relating to accounting for financial instruments. **[paras 42, 52-53]**

Annex I

Publications of the Basel Committee including recommendations on accounting and disclosure

1. In September 1997 the Committee published a set of *Core Principles for Effective Banking Supervision.* The Core Principles include guidance on the need for sound accounting and disclosure practices. For example, Principle 8 emphasises the Committee's commitment to banks establishing appropriate accounting policies and procedures for evaluating the quality of assets and the adequacy of loan loss provisions and loan loss reserves. In addition, Principle 21 requires a bank to publish on a regular basis financial statements that fairly reflect its condition.

2. The Committee has elaborated on the Core Principles in a number of other policy releases that provide guidance to supervisors and banks. In particular, the Committee's extensive policy releases that relate to accounting and disclosure reflect its recognition of the role of sound accounting and disclosure standards and practices in effective banking supervisory frameworks and sound systems.

Enhancing Bank Transparency: September 1998

This report discusses the important role of information in facilitating effective market discipline and effective banking supervision. It provides general guidance to banking supervisors and regulators as they formulate and seek to improve regulatory frameworks for public disclosure and supervisory reporting. It also provides guidance to the banking industry on six broad categories of public disclosure which are intended to improve bank transparency. This paper further recommends that banks provide timely information in their financial reports and other disclosures to the public, which facilitates the ability of market participants to assess their condition.

Sound Practices for Loan Accounting and Disclosure: July 1999

This policy release provides guidance to banks and banking supervisors on recognition and measurement of loans, establishment of loan loss allowances, credit risk disclosure and related matters. It sets out banking supervisors' views on sound loan accounting and disclosure practices for banks and discusses related emerging issues that are under review by the Basel Committee. The paper also serves as a basic framework for supervisory evaluation of banks' policies and practices in these areas. It may also be helpful to accounting standard setters.

Best Practices for Credit Risk Disclosure: consultative paper, July 1999

This paper identifies the types of credit risk information market participants and supervisors need in order to make a meaningful assessment of a bank, and encourages banks in all countries to disclose such information to the public.

Recommendations for Public Disclosure of Trading and Derivatives Activities of Banks and Securities Firms: October 1999

This paper, issued jointly with IOSCO, encourages banks and securities firms to provide meaningful information on their trading and derivatives activities to market participants and the general public. Both the Basel Committee and IOSCO recognise that well-informed market participants can reinforce the objectives of supervisors, depositors and investors by imposing strong market discipline on an institution to conduct its activities in a manner that is both sound and consistent with its stated business objectives. Meaningful disclosures also strengthens the stability of financial markets.

Annex II

Criteria used in the
Basel Committee's evaluation of IAS

General evaluation criteria

1. Accounting standards should contribute to – or at least be consistent with (not hamper) – sound risk management and control practices in banks. As well, they should provide a prudent and reliable framework for the generation of high-quality accounting information in banks.

Adequate accounting policies and practices are an essential part of a sound and effective risk management process in a bank. Accounting standards influence the way in which risks are being measured, and therefore the way they are managed and controlled.

The quality of financial figures is also important. It is essential that accounting standards should provide a prudent and reliable framework for the generation of high-quality financial information for both internal and external purposes. Such standards determine how assets and liabilities, income and expenses and capital reserves are measured.

Weak or inadequate accounting standards have the potential to hamper sound risk management and control practices in banks by concealing risk exposures or providing opportunity to hide losses or manage earnings. For instance, and as indicated in the Basel Committee's paper Sound Practices for Loan Accounting and Disclosure, unless loan impairment is identified and losses recognised in a timely manner, a bank may well persist in highly risky lending strategies or practices and thus accumulate significant loan losses, possibly resulting in failure.

2. Accounting standards should facilitate market discipline by promoting transparent financial reporting of banks' financial position and performance, risk exposures and risk management activities

Disclosure of reliable information based on sound accounting principles and internal control systems facilitates market discipline and strengthens confidence in the banking system. Market discipline reinforces supervisory efforts to promote safety and soundness by imposing incentives on banks to conduct their business in a safe, sound and efficient manner and to maintain a strong capital base. In contrast, insufficient disclosure increases the chance that misleading information could cause market instability. By facilitating market discipline, accounting and disclosure help reinforce supervisory efforts to encourage banks and other market participants to maintain sound risk management practices and internal controls.

3. Accounting standards should facilitate and not constrain the effective supervision of banks

Sound accounting principles and practices are key to a number of supervisory approaches to promote the safety and soundness of banks and banking systems as a whole. The effectiveness of banking supervision is dependent on the quality of accounting standards for many reasons, including:[9]

- Quantitative supervisory approaches, including minimum capital ratios and requirements, and limits on large exposures, rely on sound and prudent valuation standards. Without sound accounting standards, assets and capital would not be appropriately measured and, as a consequence, the usefulness of capital adequacy requirements would be undermined.

- Supervisors' efforts to promote sound business, risk management and control practices in banks are reinforced by high-quality accounting standards.

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9 In countries where accounting standards do not generate reliable and comparable information, supervisors may need to formulate rules for supervisory reporting and capital purposes that deviate from accounting standards. However, in some countries supervisors have limited legal authority to specify regulatory accounting rules. It is also necessary to consider the additional burden on banks (and their supervisors) of separate regulatory accounting requirements.

- Accounting standards affect the information that is available for examinations and other supervisory purposes. Weak or inadequate accounting standards make it difficult to make proper assessments of banks.

Specific evaluation criteria

To a greater or lesser extent, *each* of the specific criteria affects whether accounting principles contribute to fulfilment of the three general criteria identified above. The specific criteria should be viewed with attention to issues that are of particular relevance to banks.

1. Accounting principles should generate relevant and meaningful accounting information

Accounting principles should generate information that is relevant and meaningful to the internal information needs of banks and to the needs of market participants and banking supervisors. Accounting principles should not only be consistent with concepts underlying the preparation and presentation of financial statements, but also with accepted economic principles underlying capital markets and rational risk management practices. In particular, it is important that accounting standards evolve over time in order to address financial innovation and developments in markets and risk management techniques.

2. Accounting principles should generate prudent and realistic measurements of financial position and performance

Accounting principles should reflect prudent and realistic measurements of assets and liabilities, related profits and losses, and capital. Accounting principles should not require or permit the overstatement of assets, equity or income, or the understatement of liabilities or expenses. However, accounting standards should also not allow the establishment of hidden reserves through undervaluation of assets or overaccrual of liabilities.

3. Accounting principles should generate reliable measurements of financial position and performance

To be reliable, accounting information should represent faithfully that which it purports to represent or could reasonably be expected to represent; should reflect the economic substance of events and transactions and not merely their legal form; should be verifiable; should be timely; should be neutral, i.e., free from material error or bias; should be prudent; and should be complete in all material respects.

4. Accounting standards should not only have a sound theoretical foundation, but also be workable in practice

It is not sufficient that accounting standards can be justified theoretically. They should also be operable in practice, justifiable on a cost-benefit basis, and meet the needs of information users. Accounting standards should not put undue burden and cost on banks by requiring them to maintain special accounting systems that are not consistent with internal risk management systems unless for good reasons.

5. Accounting standards should not be overly complex in relation to the issue addressed

Accounting standards should not be so complex that it is difficult to control and audit compliance. Financially literate users of financial statements should be able to fully understand what the accounting information produced represents.

6. Accounting principles should generate consistent measurements of similar or related items

Accounting principles should result in consistent treatment of similar or related items. This avoids distortion of economic incentives and potential disparities between financial statement reporting and the economic substance of financial transactions.

7. Accounting standards should be sufficiently precise to ensure consistent application

Accounting standards should not be written in too broad terms, but prudently limit the scope for management discretion. Reasonably specific application guidance should be provided as appropriate, e.g., illustrative examples. Accounting standards should not be so vague that auditors and supervisors are not able to control adherence and address possible abuses.

8. Preferably, accounting standards should not allow alternative treatments. When alternative accounting treatments are permitted, or judgements are necessary in applying accounting principles, balanced disclosures should be required

It is important that accounting information is comparable across institutions. Peer comparisons are a key tool for supervisors, bank management and markets. Also differences in accounting treatment may be a source of competitive distortions. Therefore, accounting standards preferably should not allow alternative treatments.

To ensure comparability, balanced disclosures should be required when alternative accounting treatments are permitted or there is significant scope for judgement in applying accounting principles.

9. Disclosures should be sufficiently comprehensive for an assessment of a bank's financial position and performance, risk exposures and risk management activities

Without comprehensive disclosures allowing a proper assessment of a bank's financial position and performance, risk profile and its methods and performance in managing risk, the quality of the information available to market participants and supervisors diminishes substantially. Disclosures also should illuminate major accounting methodologies employed and any material changes to such methodologies.

10. International Accounting Standards should be suitable for implementation not only in the most advanced financial markets but also in emerging markets

International Accounting Standards (IASs) are particularly important in countries without a developed national accounting standard-setting process such as many non-G10 countries. Therefore, IASs should be suitable for implementation also in countries with less developed financial markets. However, this does not imply that IASs should not also ensure reasonable accounting in more developed financial markets.

Annex III

List of International Accounting Standards (IAS)

(reviewed by Accounting Task Force)

IAS	SIC	Title	Effective date
IAS 1	8	Presentation of Financial Statements	1. 7.98
IAS 8		Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies	1. 1.79
IAS 10		Events after the Balance Sheet Date	1. 1.00
IAS12		Taxes	1.1.98
IAS 17	15	Leases	1. 1.84
IAS 18		Revenue	1 .1.84
IAS 21	7,11	The Effects of Changes in Foreign Exchange Rates	1. 1.85
IAS 22	9	Business Combinations	1 .1.85
IAS 27	12	Consolidated Financial Statements and Accounting for Investments in Subsidiaries	1. 1.90
IAS 28	3	Accounting for Investments in Associates	1. 1.90
IAS 30		Disclosures in the Financial Statements of Banks and Similar Financial Institutions	1. 1.91
IAS 31	13	Financial Reporting of Interests in Joint Ventures	1. 1.92
IAS 32	5,16	Financial Instruments: Disclosures and Presentation	1. 1.96
IAS 37		Provisions, Contingent Liabilities and Contingent Assets	1. 7.99
IAS 39		Financial Instruments: Recognition and Measurement	1. 1.01

Annex IV

Summarised findings

(a) Standards where there are no issues of supervisory concern

IAS	SIC	TITLE
IAS 1	8	Presentation of Financial Statements
IAS 8		Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies
IAS 10		Events after the Balance Sheet Date
IAS 18		Revenue
IAS 21	7,11	The Effects of Changes in Foreign Exchange Rates
IAS 22	9	Business Combinations
IAS 28	3	Accounting for Investments in Associates

(b) Standards where there are issues of concern from a supervisory perspective

IAS	SIC	TITLE	ISSUES	RESOLUTION
IAS 12		Taxes	Deferred tax assets and liabilities must be measured at nominal amounts, with no discounting. No regard must be taken of the probability of deferred tax assets or liabilities crystallising.	The IASC project on discounting may address the question of dealing with deferred tax assets and liabilities.
IAS 17	15	Leases	The boundaries in the classification between operating and finance leases are somewhat arbitrary, and may be circumvented to achieve a more favourable accounting treatment.	The issue of lease accounting is on the future agenda of IASC.
IAS 27	12	Consolidated Financial Statements and Accounting for Investments in Subsidiaries	There is a need for intermediate holding companies to prepare group accounts: if banks, this should be a requirement. Provided the terms of a securitisation meet the requirements of the supervisor, consolidation of the special purpose entity, which is required by SIC 12, may not be required for capital adequacy purposes.	IASC has been advised that regulated banks which are intermediate holding companies should be required to prepare group accounts. IASC has been advised of our view of SIC12.
IAS 30		Disclosures in the Financial Statements of Banks and Similar Financial Institutions	Does not reflect market developments since 1991. For example, additional disclosures are recommended in several Basel papers, including one issued jointly with IOSCO[10]	IASC have established a steering group to review and update IAS30.

[10] Enhancing Bank Transparency (September 1998)

Sound Practices for Loan Accounting and Disclosure (July 1999)

Best Practices for Credit Risk Disclosures (July 1999)

Recommendations for Public Disclosure of Trading and Derivatives Activities of Banks and Securities Firms (Joint with IOSCO) (October 1999)

See Annex I for further information on these papers

IAS 31	13	Financial Reporting of Interests in Joint Ventures	Choice of treatments allowed (proportionate consolidation or equity method) may lead to inconsistencies, both generally and in relation to measuring supervisory capital.	IASC has been advised to consider eliminating equity accounting alternative, or the Committee will consider only allowing proportionate consolidation to be used for measuring group capital.
IAS 32	5,16	Financial Instruments: Disclosures and Presentation	Distinction between debt and equity may not be able to be implemented in several jurisdictions, as legal structures would not permit	Need to revise as part of the longer term fair value project, and the new project to revise IAS 30
IAS 37		Provisions, Contingent Liabilities and Contingent Assets	Use of present value when measuring provisions is specified, but there is no guidance on how to do this.	Discounting project may resolve approaches to be applied to provisions.
IAS 39		Financial Instruments: Recognition and Measurement	Many issues of concern (see text of Basel report)	See text of Basel report