II

*(Preparatory Acts)*

# COMMISSION

## Proposal for a Directive of the European Parliament and of the Council amending Directives 78/660/EEC and 83/349/EEC as regards the valuation rules for the annual and consolidated accounts of certain types of companies

(2000/C 311 E/01)

*COM(2000) 80 final — 2000/0043(COD)*

*(Submitted by the Commission on 24 February 2000)*

THE EUROPEAN PARLIAMENT AND THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 44,

Having regard to the proposal from the Commission,

Having regard to the opinion of the Economic and Social Committee,

Acting in accordance with the procedure laid down in Article 251 of the Treaty,

Whereas:

(1) Article 32 of the Directive 78/660/EEC based on Article 54(3)(g) (now 44(2)(g)) [1] of the Treaty requires the items shown in the annual accounts to be valued on the basis of the principle of purchase price or production cost.

(2) Article 33 of Directive 78/660/EEC authorises Member States to permit or require companies to re-value certain assets, to value certain assets at replacement cost or to apply other methods that take into account the effects of inflation on the items shown in the annual accounts.

(3) Article 29 of Directive 83/349/EEC based on Article 54(3)(g) (now 44(2)(g)) [2] of the Treaty requires assets and liabilities to be included in consolidated accounts to be valued in accordance with Articles 31 to 42 and 60 of Directive 78/660/EEC.

(4) The annual and consolidated accounts of banks and other financial institutions are prepared in accordance to Council Directive 86/635/EEC, and the annual and consolidated accounts of insurance undertakings are prepared in accordance with Council Directive 91/674/EEC. The amendments in this Directive do not amend the provisions of Directives 86/635/EEC and 91/674/EEC, but the Commission may bring forward similar proposals to amend these Directives after having consulted the relevant advisory committees.

(5) The dynamic nature of international financial markets has resulted in the widespread use of not only traditional primary financial instruments such as shares and bonds, but also various forms of derivative financial instruments as futures, options, forward contracts and swaps.

(6) Leading accounting standard setters in the world are moving away from the historical cost model for the valuation of these financial instruments towards a model of fair value accounting.

(7) The Communication of the Commission on 'Accounting Harmonisation: A New Strategy vis à vis International Harmonisation' [3], called for the EU to work to maintain consistency between Directives 78/660/EEC and 83/349/EEC and developments in international accounting standard setting.

(8) In order to maintain consistency between internationally recognised accounting standards and Directives 78/660/EEC and Directive 83/349/EEC, it is necessary to amend these Directives in order to allow for certain financial assets and liabilities to be valued at fair value. This will enable European companies to report in line with current international developments.

(9) Comparability of financial information throughout the Community makes it necessary to require Member States to introduce a system of fair value accounting. Member States may permit or require the adoption of that system to all or certain categories of companies and to both the annual and consolidated accounts or to consolidated accounts only.

(10) Fair value accounting should only be possible for those items where there is a sufficiently developed international consensus that fair value accounting is appropriate. Fair value accounting should therefore not be applied to all financial assets and liabilities.

(11) The notes on the accounts should include certain information concerning the items in the balance sheet which have been measured at fair value. The annual report should give an indication of the company's risk management objectives and strategies in relation to its use of financial instruments.

(12) Accounting for financial instruments is a fast evolving area of financial reporting which necessitates a periodic review. This review should be carried out through the Contact Committee on the Accounting Directives in order to give Member States the opportunity to report on their experiences with fair value accounting in practice,

[1] OJ L 222, 14.8.1978, p. 11. Directive as last amended by Directive 1999/60/EC (OJ L 162, 26.6.1999, p. 65).

[2] OJ L 193, 18.7.1983, p. 1. Directive as last amended by Directive 90/605/EEC (OJ L 317, 16.11.1990, p. 60).

[3] COM(95) 508.

HAVE ADOPTED THIS DIRECTIVE:

*Article 1*

Directive 78/660/EEC is hereby amended as follows:

1. The following Section 7a is inserted:

'SECTION 7a

**Valuation at fair value**

*Article 42a*

1. By way of derogation from Article 32, Member States shall permit or require in respect of all companies or any classes of companies, valuation at fair value of all balance sheet items, including derivative financial instruments, except for the items listed in paragraph 3.

2. Member States may restrict the permission or requirement set out in paragraph 1 to consolidated accounts as defined in Directive 83/349/EEC.

3. The following items shall not be valued at fair value:

(a) balance sheet items that are not financial instruments;

(b) liabilities, with the exception of liabilities which are:

(i) held as part of a trading portfolio;

(ii) accounted for as hedged items; or

(iii) derivative financial instruments.

4. Notwithstanding paragraph 1, Member States may:

(a) exclude items held-to-maturity, other than derivative financial instruments, from valuation at fair value;

(b) exclude originated loans and advances not held for trading purposes from valuation at fair value;

(c) restrict the valuation at fair value to items held for trading purposes. Where this restriction is applied, all derivative financial instruments are deemed to be held for trading purposes;

(d) exclude commodity-based contracts that were originally designated for the purposes of meeting a company's expected purchase, sale or usage requirements in that commodity and which are expected to be settled by delivery of the commodity.

*Article 42b*

1. The fair value referred to in Article 42a is determined by reference to:

(a) a market value, for those items for which a reliable market can readily be identified. Where a market value is not readily identifiable for an item but can be identified for its components, the market value of that item may be derived from that of its components; or

(b) the value resulting from established valuation models and techniques, for those items for which a reliable market cannot be readily identified. Such valuation models and techniques should ensure a reasonable approximation of the market value.

2. Those items that cannot be measured reliably in a way that is free from material error and bias by the methods as described under either (a) or (b) of paragraph 1, may not be measured at fair value and should instead be measured in accordance with Articles 34 to 42.

*Article 42c*

1. Notwithstanding Article 31(1)(c)(aa), where a balance sheet item has been valued at fair value in accordance with Article 42a (1) a change in the fair value of that item should be included in the profit and loss account in arriving at the profit or loss for the financial year.

2. Member States may permit or require the gain or loss on a financial asset that is not held for trading purposes to be recognised directly in equity, in a fair value reserve. To the extent that gains and losses on such items that have been recognised in equity are actually realised, they must be removed from the fair value reserve. The Member States may lay down rules governing the use of the fair value reserve.

3. Notwithstanding paragraph 1, the change in the fair value of an item measured in accordance with Article 42b should not be included in the profit and loss account in arriving at the profit or loss for the financial year, but must be included directly in the fair value reserve where:

(a) that item is accounted for as a hedging instrument under a system of hedge accounting that allows such changes in value not to be shown in the profit and loss account, or

(b) such change in value relates to an exchange difference arising on a monetary item that forms part of a company's net investment in an affiliated foreign undertaking.

4. The fair value reserve referred to in paragraph 3 should be reduced to the extent that the amounts shown therein are no longer necessary for the implementation of the valuation methods under the circumstances referred to in sub-paragraphs (a) and (b) of paragraph 3. The Member States may lay down rules governing the use of the fair value reserve.'

2. The following Articles 43a, 43b and 43c are inserted:

'*Article 43a*

Where valuation at fair value has been applied under Article 42a, the notes on the accounts must indicate at least the following information:

(a) the items in the balance sheet that have been measured at fair value;

(b) where fair values have been determined in accordance with Article 42b(1)(b), the significant assumptions underlying the valuation models and techniques;

(c) per category of items measured at fair value, the fair value, and the profits or losses recognised directly in the profit and loss account and in the fair value reserve referred to in Article 42c(3);

(d) for the fair value reserve referred to in Article 42c(2) and Article 42c(3) a table showing separately:

(i) the amount of the reserve at the beginning of the financial year;

(ii) the differences included in the reserve during the financial year;

(iii) the amounts transferred from the reserve during the financial year and the nature of any such transfers;

(iv) the amount of the reserve at the end of the financial year;

(e) for each class of derivative financial instruments, information about the extent and nature of the derivative financial instruments, including significant terms and conditions that may affect the amount, timing and certainty of future cash flows

*Article 43b*

When a company is permitted to use valuation at fair value in accordance with Article 42a(1), but decides not to do so, the following disclosures should be given for each class of derivative financial instruments:

(a) information about the extent and nature of the derivative financial instruments, including significant terms and conditions that may affect the amount, timing and certainty of future cash flows;

(b) the fair value of the derivative financial instruments.

*Article 43c*

Where valuation at fair value has not been applied under Article 42a(1), and where a company has not made use of the option to make a value adjustment in respect of a financial fixed asset in accordance with Article 35(1)(c)(aa) and therefore carries that financial fixed asset at an amount in excess of its fair value, it should disclose:

(a) the book value and the fair value of either the individual assets or appropriate groupings of those individual assets; and

(b) the reasons for not reducing the book value, including the nature of the evidence that provides the basis for the belief that the book value will be recovered.'

3. The following Article 46a is inserted:

'*Article 46a*

Whether or not use has been made of valuation at fair value referred to in Section 7a, the annual report shall give an indication of:

(a) the company's financial risk management objectives and strategies in relation to its use of financial instruments, and how these objectives are implemented; and

(b) the company's exposure to price risk, credit risk, liquidity risk, counter-party risk, cash flow risk and risk of future developments in relation to its use of financial instruments.'

4. The following Article 52a is inserted:

'*Article 52a*

The Parliament and the Council shall, acting in accordance with the procedure laid down in Article 251 of the Treaty, acting on a proposal from the Commission and within three years of the adoption of this Directive, examine and, where necessary, amend Articles 42a, 42b, 42c, 43a, 43b, 43c and 46a of Directive 78/660/EEC in the light of the experience acquired in applying these Articles and taking account of international developments in the field of accounting.'

*Article 2*

Directive 83/349/EEC is hereby amended as follows:

1. The following Articles 34a, 34b and 34c are inserted:

'*Article 34a*

Where valuation at fair value has been applied in accordance with Article 42a(1) of Directive 78/660/EEC, the notes on the consolidated accounts must indicate at least the following information:

(a) the items in the consolidated balance sheet that have been measured at fair value;

(b) where fair values have been determined in accordance with Article 42b(1)(b) of Directive 78/660/EEC, the significant assumptions underlying the valuation models and techniques;

(c) per category of items measured at fair value, the fair value, and the profits or losses recognised directly in the consolidated profit and loss account and in the fair value reserve referred to in Article 42c(3) of Directive 78/660/EEC;

(d) for the fair value reserve referred to in Article 42c(2) and Article 42c(3) of Directive 78/660/EEC a table showing separately:

(i) the amount of the reserve at the beginning of the financial year;

(ii) the differences included in the reserve during the financial year;

(iii) the amounts transferred from the reserve during the financial year and the nature of any such transfers;

(iv) the amount of the reserve at the end of the financial year;

(e) for each class of derivative financial instruments, information about the extent and nature of the derivative financial instruments, including significant terms and conditions that may affect the amount, timing and certainty of future cash flows.

*Article 34b*

When a company is permitted to use valuation at fair value in accordance with Article 42a(1) of Directive 78/660/EEC, but decides not to do so, the following disclosures should be given for each class of derivative financial instruments:

(a) information about the extent and nature of the derivative financial instruments, including significant terms and conditions that may affect the amount, timing and certainty of future cash flows;

(b) the fair value of the derivative financial instruments.

*Article 34c*

Where an undertaking included in the consolidation has not applied valuation at fair value under Article 42a(1) of Directive 78/660/EEC and has not made a value adjustment in respect of a financial fixed asset in accordance with Article 35(1)(c)(aa) of Directive 78/660/EEC, and therefore carries that financial fixed asset at an amount in excess of its fair value the notes on the consolidated accounts must disclose:

(a) the book value and the fair value of either the individual assets or appropriate groupings of those individual assets; and

(b) the reasons for not reducing the book value, including the nature of the evidence that provides the basis for the belief that the book value will be recovered.'

2. The following Article 36a is inserted:

'*Article 36a*

Whether or not use has been made of valuation at fair value referred to in Section 7a of Directive 78/660/EEC, the consolidated annual report shall give an indication of:

(a) the undertaking's financial risk management objectives, and how these objectives are met through its use of financial instruments; and

(b) information on the undertaking's exposure to price risk, credit risk, liquidity risk, counter-party risk, cash flow risk and risk of future developments in relation to its use of financial instruments.'

3. The following Article 48 is inserted:

'*Article 48*

The Parliament and the Council shall, acting in accordance with the procedure laid down in Article 251 of the Treaty on a proposal from the Commission and within three years of the adoption of this Directive, examine and, where necessary, amend Articles 34a, 34b, 34c and 36a of Directive 83/349/EEC in the light of the experience acquired in applying these Articles and taking account of international developments in the field of accounting.'

*Article 3*

1. Member States shall bring into force the laws, regulations and administrative provisions necessary for them to comply with this Directive before . . . They shall forthwith inform the Commission thereof.

When Member States adopt these provisions, they shall contain a reference to this Directive or shall be accompanied by such reference on the occasion of their official publication. The methods for making such reference shall be laid down by Member States.

2. Member States shall communicate to the Commission the main provisions of domestic law which they adopt in the field governed by this Directive.

*Article 4*

This Directive shall enter into force on the twentieth day following its publication in the *Official Journal of the European Communities*.

*Article 5*

This Directive is addressed to the Member States.