EU Unveils Awaited Proposal For Fair-Value Accounting

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BRUSSELS -- In a move designed to make the books of big European companies more open, the European Commission unveiled a long-expected proposal for the introduction of fair-value accounting standards, which require businesses to disclose their investments in risky financial instruments.

The proposal will harmonize the European Union's obsolete accounting directives with those accepted by the International Accounting Standards Committee and widely used in the U.S. Indirectly, the proposal is also expected to increase the competitiveness of European companies on global capital markets by making them more open both to investors and to venture capitalists.

"Some companies are now using financial instruments that can transform their financial position and risk profile overnight," the commission said in its proposal, which has to be accepted by the Council and the European Parliament. "The present form and substance of the financial reporting on these instruments does not always reflect their impact and associated risks," the commission added.

Traditionally, companies in the EU had to use the so-called cost-valuation model for their accounting. This model relies on the historical value of assets and investments for determining a company's financial situation.

But the problem is that "the dynamic nature of international financial markets has now 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 such as futures, options, forward contracts and swaps," the commission said.

Indeed, the past decade has seen no shortage of companies being sucked into risky derivative trading without disclosing most of their gambles to investors. An example often cited by critics is Metallgesellschaft AG, which in the mid-90s racked up losses totaling nearly $1 billion on the trading of swaps and futures involving oil products.

Both the industry and accounting associations welcomed the commission's proposal, unveiled Friday. "It is absolutely in line with what we have been saying so far," said Fiona Marcq, directory of company affairs at UNICE, a Brussels-based employers' and industry association. The International Accounting Standards Committee said it, too, was pleased with the commission's initiative.

The EU's old accounting rules presented a hurdle for European companies that wanted to follow international standards, but couldn't do so because of the historical-valuation models imposed on them in the union's directives.
The new proposal will require EU member states either to give companies the option of choosing between the old and new methods or to require them to abide by new rules.

"This is in the interest of those typically large EU companies that wish to report using International Accounting Standards because the international capital markets on which they raise capital demand that they report under internationally recognized accounting standards," the commission said. The proposal exempts smaller companies and banks from fair-value requirements.

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