

IAS 39 Necessary for Strengthened Accounting

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As we all know, unclear information on the risk exposure of derivatives can lead to wrong economic decisions and financial losses. Under IAS (International Accounting Standards) 39, these derivatives are required to be marked to market and recorded on balance sheets. At the same time, gains and losses should be included in income statements.

It is a fact that IAS 39 has both pros and cons. While it is fundamentally a respected, principle-based concept, the validity of its "fair-value accounting", disclosure requirements and transparency of accounting information have been widely criticised.

Further more, an incurred-loss model has become a prudential concern for all regulators, since no expected loss is allowed to be recorded as an impairment loss under IAS 39. While "dynamic provisioning", which takes into account future losses, has been proposed as a way to correct the weakness, this concept is not acceptable by accounting standards.

According to a study by the US Securities and Exchange Commission, fair-value accounting has been proved irrelevant to the US financial crisis.

In fact, the liquidations and bankruptcies in the US were mainly caused by low credit quality and loss of confidence. The current problem for US financial institutions seems to stem from market failure, which leads to deep discounts in the fair value of financial instruments. Although there are excess losses from marking to market, suspending fair-value accounting might bring more serious concern about transparency and good governance. Indeed, this problem can be alleviated by a certain flexibility provided by IAS 39.

For example, management assumptions and internal models are allowed for measurement of illiquid instruments. Also, valuation adjustment is acceptable when it can reflect more reliable information.

In Thailand, financial institutions have already adopted some parts of IAS 39, for example the impairment of loans and accounting for embedded derivatives, as required by the Bank of

Thailand. At present, responsible entities are working toward full implementation, which is expected in 2011. In responding to industry comments, the transition plan has been discussed to reduce obstacles and to provide reasonable and practical approaches for all entities.

The challenge ahead for Thai financial institutions is how to manage themselves through the transition period. While the implementation process requires a lot of effort, the benefits from having high-quality financial reporting will reward not only financial institutions themselves but also the Thai financial system as a whole.

Although highly complex financial instruments such as CDOs (collateralised debt obligations) and securitisation may diminish for the time being, some financial transactions like structured notes and structured deposits still exist and require clear accounting guidelines.

There is also demand from market participants for harmonisation of accounting standards. This issue will be more important for internationally active banks that have presence in many countries, and for financial institutions that would like to raise funds abroad.

Accounting experts still believe that IAS 39 is necessary for the accounting records of financial institutions. Regardless of its limitations, IAS 39 is currently the most suitable accounting standard for financial firms. By applying IAS 39, financial statements will be more comparable across countries, resulting in greater investor confidence. Therefore, refusing to implement the whole standard is not the way to avoid its disadvantages.

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