Committee of European Banking Supervisors

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3 November 2006

Sir David Tweedie
Chairman of the
International Accounting Standards Board
30 Cannon Street,
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Dear Sir David

Discussion Paper - Preliminary Views on an improved Conceptual Framework for Financial Reporting: The Objective of Financial Reporting and Qualitative Characteristics of Decision-useful Financial Reporting Information

The Committee of European Banking Supervisors (CEBS) welcomes the opportunity to comment on the Discussion Paper about Preliminary Views on an improved Conceptual Framework for Financial Reporting published by the IASB, jointly with the FASB.

Banking supervisory authorities, as users of banks' financial statements, have a strong interest in promoting sound and high quality accounting and disclosure standards for the banking and financial industry, as well as transparent and comparable financial statements that would strengthen market discipline and enhance financial stability.

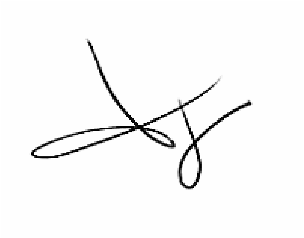
We regard the conceptual framework project as a key step in the accounting standards international convergence process, as well as in the IASB's efforts for developing principles-based, sound and internationally accepted accounting standards. The Committee will continue to monitor the different phases of the project and is looking forward to contributing further to this important debate.

With regard to the present discussion paper CEBS is of the opinion that some of the conclusions drawn in the paper need more discussion in the further development of the project. The remainder of the letter further elaborates on the topics and issues on which CEBS has major concerns or which it would like to be further discussed.

The comments below have been prepared by one of CEBS' expert groups, the Expert Group on Financial Information (EGFI), chaired by Mr. Arnoud Vossen, in charge of monitoring any developments in that area and of preparing positions to be taken by CEBS. The development of our comments on this Discussion Paper was coordinated by a Subgroup of EGFI under the direction of Mr. Patrick Amis.

If you have any questions regarding our comments, please feel free to contact Mr. Arnoud Vossen (+31.20.524.3903) or Mr. Patrick Amis (+ 33.1.4292.6032).

Yours sincerely



Danièle Nouy
Chair

General Comments

Before presenting specific comments, we would like to underline some key remarks on the Discussion Paper, which encompass both conceptual and practical considerations.

First, we would like to encourage the IASB to promote further debate with the FASB concerning the authoritative status of the Framework. As a matter of fact, at present, whereas IFRS preparers are required to refer to the Conceptual Framework in the absence of guidance in the standards, this is not required in US GAAP. There is a risk that the implementation and understanding of the Framework, both by preparers and users, could be impaired by such a discrepancy. We have noted that the Boards plan to address the issue in future steps of their joint project. However, we believe that the authoritative status of the jointly designed framework is a fundamental aspect of the process and should be addressed as soon as possible in the interest of its consistent application.

In that respect, we have a strong preference for a principles based framework, with a high authoritative status accorded to the Framework, as a minimum of the kind that currently exists in relation to IAS 8. Moreover, we would expect that – as a matter of principle - future standards will be consistent with the Framework. We would encourage the IASB to introduce in its due process a “comply or explain” mechanism in this regard - in the hopefully limited cases where a new standard was inconsistent with the revised Framework, the Board would need to explain the reasons for this.

Second, we would like to stress two important areas of concern about the Discussion Paper, the first one being the importance of the assessment of management’s stewardship as a separate objective of financial reporting; the second one regarding the replacement of the concept of reliability with faithful representation and the proper balance between the qualitative characteristics of financial reporting. Those two aspects are addressed more fully in our detailed comments.

Third, we believe that the Discussion Paper - despite the clear distinction which is made between the “Objectives of Financial Reporting” (OB) and the “Qualitative Characteristics of Decision-Useful Financial Reporting Information” (QC) – is somewhat diffuse. We consider that the final version of the document should be expressed more incisively, and in particular make it easier for the reader to grasp what precisely is the respective importance of each component of the objective and qualitative characteristics of financial reporting.

More detailed comments on the two chapters of the Discussion Paper are provided below.

Comments on Chapter 1 – The objective of financial reporting (OB)

OB2 clearly states that the objective of financial reporting is to provide information that is useful in making investment, credit, and similar resource allocation decisions. We are not convinced by this definition, which we perceive as too narrow, or with the – nearly exclusive (see OB3) - reliance on the assessment of future cash flows to meet this objective.

CEBS is convinced that the accountability of management to owners and creditors for the custody and safekeeping of the entity's economic resources, and for their efficient and profitable use in past periods, is a key aspect of financial reporting for users and preparers, as well as for corporate governance more generally. For instance, banking supervisors in their role of monitoring banking activity, and banks when assessing the financial situation of their counterparties, make significant use of financial reporting in order to assess management's stewardship. Hence, we recommend that the assessment of management's stewardship should be set as a separate objective of financial reporting.

In the same way, we believe that the assessment of future cash flows is only one component of the objective of financial reporting. For instance, the current framework mentions solvency as another important component, a concept that we fully support. Indeed, assessment of the solvency of financial institutions, and other counterparties to financial transactions, is fundamental to the operation of the economy.

We noted that the Discussion Paper replaced the notion of financial statements with the notion of financial reporting in the Framework. However the boundary of financial reporting does not seem to be defined clearly in the document, and this could have very material impacts on the ability of other authorities to impose specific financial reporting without being compliant, necessarily, with the IFRS as well as, potentially, on audit requirements. For this reason, we recommend that the IASB should consider very carefully the legal implications of this change before making any decision on that issue. We made a similar comment in our letter about the Discussion Paper – Management Commentary published by the IASB.

We noted also that the Discussion Paper makes use of the terms "claims" and "resources" and would welcome a clarification about the underlying reasons that justify the change of terminology.

Finally, we would like to express strong support for the new definition of users and primary users in the preliminary views OB.

Comments on Chapter 2 – Qualitative characteristics of Decision-Useful Financial Reporting Information (QC)

The Discussion Paper proposes to replace the concept of "reliability" with "faithful representation", while deleting "prudence" and "substance over form" as explicit components of this qualitative characteristic.

We are not sure that the concept and the precise definition of "faithful representation" have a clear and internationally accepted meaning. Notably, we are concerned that the redefined notion might not convey with the same force as "reliability" the paramount importance of professional and objective judgment, especially in challenging areas of recognition and measurement such as the valuation process of illiquid instruments traded in imperfect markets. In that respect, it should be strongly emphasised that overly optimistic measurements would be inconsistent with the need for neutrality, for instance when extended ranges of estimates exist for highly illiquid transactions.

In the same way we believe that the definition of verifiability - one of the three components of faithful representation - should be reinforced and we agree on this point with the alternative view expressed in AV2.1 and AV2.2.

The proposed qualitative characteristics consist of considering first relevance, then faithful representation, and finally comparability and understandability. Although we noted that the Boards do not intend to give more prominence to one characteristic or another, the fact that relevance should be assessed first could be interpreted, nevertheless, as implying a kind of hierarchical order between the qualitative characteristics. We recommend that the Framework contains an explicit statement emphasising that appropriate balance should be maintained between relevance and faithful representation, in order to avoid giving the impression that the importance placed on reliable measurements is reduced.

In the same way, the Discussion Paper seems to put a lot of emphasis on predictive value as a key component of relevance. We would like to stress also the importance of appropriate balance between predictive value and confirmatory value, the latter being linked with the assessment of management's stewardship.

Finally we believe 'substance over form' is a key qualitative characteristic of high-quality financial information and as such should be retained as a distinct feature of the Framework.