Committee of European Banking Supervisors

7 April 2005

CONSULTATION PAPER ON FINANCIAL REPORTING

1. Introduction

This paper provides background to, and an explanation of, the consolidated financial reporting framework for credit institutions that has been developed over the last several months by the Committee of European Banking Supervisors (CEBS). In March 2005 the framework was approved for public consultation.

2. Description of the project

The project aims at developing a standardised consolidated financial reporting framework for credit institutions that is consistent with international accounting standards (IAS/IFRS). The framework is not intended to cover all aspects of IAS/IFRS.[1] It is intended for use by EU supervisory authorities when they ask credit institutions to submit consolidated financial information prepared in accordance with IAS/IFRS.[2]

The framework is not intended to be mandatory. Each national supervisor will decide how extensively the framework is to be implemented within its jurisdiction.

Annex 1 contains the proposed reporting framework. Annex 2 provides brief explanatory guidance.

3. Background

As of 1 January 2005, in accordance with Regulation (EC) 1606/2002 of the European Parliament and of the Council of 19 July 2002, all listed European credit institutions are required to use IAS/IFRS for their consolidated financial statements. However, member states may also extend the application of IAS/IFRS to the consolidated financial statements of unlisted credit institutions.[3]

---

[1] The framework does not address all disclosure requirements contained in IAS/IFRS. However, certain elements of *Exposure Draft 7 (ED 7) Financial instruments: Disclosures* were taken into account.

[2] The framework is not intended for use in a national accounting standards environment, unless national supervisors so choose.

[3] See 'Planned Implementation of the IAS Regulation (1606/2002) in the EU and EEA (Published for information purposes only)', 17 January 2005, available at the website of the European Commission: http://europa.eu.int/comm/internal_market/index_en.htm

The project to develop a standardised consolidated financial reporting framework was motivated by the absence of prescribed reporting formats under international accounting standards. IAS/IFRS do not impose a standardised reporting format, such as the one that is currently prescribed under Council Directive 86/635/EEC of 8 December 1986 for the annual accounts and consolidated accounts of banks and other financial institutions. A standardised reporting format is important to supervisors, as it is essential for comparing information.[4]

It is not the intention of CEBS to impose additional reporting requirements, but rather to create a common financial reporting framework for the collection of data prepared under IAS/IFRS that will reduce administrative burden on cross-border banking groups and contribute to removing a potential obstacle to financial market integration. The framework's objective is to streamline the reporting process for supervisory purposes and thereby to increase the cost-effectiveness of supervision across the EU.

4. Feedback from industry

The project benefited from feedback from industry at both the national and European level. Several national supervisory authorities consulted informally with their domestic banking sectors in February 2005. In addition, CEBS held two informal meetings with representatives from the European banking industry during the development of the framework.

In general, banks reacted positively to the project. The industry expressed its appreciation for the harmonisation effort and for the potential reduction in administrative burden. Nevertheless, some concerns were raised. In particular, credit institutions stressed the need for financial reporting requirements to remain consistent with IAS/IFRS. We believe this concern has been addressed.

Another concern expressed by the industry was the need for co-ordination between financial reporting and prudential reporting on capital requirements. This has been recognised, and CEBS has begun work to address this concern.

5. Flexibility and harmonisation

There is currently a wide diversity in the supervisory practices of European authorities concerning how financial information is used for prudential purposes. Some supervisors are content to receive the 'primary financial statements' (balance sheet and income statement) published by credit institutions; others require the submission of reports that contain information that is comparable to publicly available information; while some require reporting at a finer level of detail than is provided in publicly available financial statements.

---

[4] 'Member States may wish to extend the requirement to apply IAS to facilitate sector wide comparability and to ensure efficient and effective supervision', Communication of the Commission to the Council and the European Parliament of 13 June 2000 – Com(2000) 359 Final.

This diversity of supervisory approaches makes it necessary to adopt an approach to prudential reporting which is at the same time both flexible and harmonised. CEBS believes that this has been achieved in the proposed standardised reporting framework. The framework allows each national authority to decide what financial information it will require for prudential purposes. Each supervisor is free to select from the framework those data that it considers useful in carrying out its supervisory mission. In addition, each supervisor has the option of extending the standardised reporting framework with additional information considered necessary at the national level. This approach allows each individual supervisor to collect financial information adapted to its specific needs.

However, national supervisors should refrain from omitting some parts of the framework and subsequently replacing them with individualised extensions, since such an approach would impede the harmonisation efforts of the member states.

6. Explanatory guidance

The brief explanatory guidance prepared by CEBS should be regarded only as an interpretation of presentational issues of the international accounting standards. It is the responsibility of credit institutions and their external auditors to apply the international accounting standards correctly. After an initial settling-in period, CEBS may provide additional guidance based on questions and feedback received from credit institutions, and on the experience of its members.

Particular attention is drawn to the presentation of accrued interest, as outlined in point 2 of chapter I of the proposed guidance.

7. Application – effective date and reporting frequency

As mentioned above, the practical application of the framework remains a matter of national discretion. In addition, supervisors applying the framework will decide on the date that the framework will begin to apply, and on the reporting frequency.

8. Characteristics of the reporting framework

a. Information-flow model

In addition to regulatory capital information, some supervisors request publicly available financial information on a regular basis and in a standardised format. These supervisors then apply "prudential filters" in their internal IT systems.

Other supervisors receive financial information from credit institutions after "prudential filters" have been applied, and consequently the information reported to them is not necessarily identical to publicly available information.

In both supervisory models, a standardised IAS/IFRS-consistent framework is useful to both the industry and supervisors.

b. Data model

The standardised financial reporting framework has been benchmarked to the existing IAS/IFRS, meaning that the framework contains information that a credit institution is required to publish in order to be IAS/IFRS compliant. All of the options offered by the international accounting standards are also available in the financial reporting framework. In this approach, the institution's primary financial statements are complemented by separate tables that provide more detailed information.

Particular attention has been paid to the development of comprehensive primary statements, using a layered approach, since some supervisors are satisfied with primary statements alone. The remainder of the framework is based mainly on tables (multi-dimensional model). This means that the reporting framework presented in Annex 1 is a mixture of layered primary financial statements and a more comprehensive set of tables. This may result in redundancies, which can be eliminated at the national level.

The data model is important for IT departments, as it determines which data attributes need to be stored when the framework is applied: not only accounting information but also information about the type of portfolio, the type of instrument, the nature of the counterparty, the maturity breakdown, and any other information needed.

c. Availability of data

Since the reporting framework is IAS/IFRS-consistent, the data in the framework are assumed already to be available within credit institutions' IT systems.

d. Consolidation scope

The consolidation scope under IAS/IFRS differs from the consolidation scope of the Capital Requirements Directive. This should not present a problem for the reporting framework, however, since its consolidation scope will be decided by each national supervisor. Some supervisors may choose to define their financial information requirements in terms of the capital consolidation scope, while others may prefer to collect financial information in terms of the accounting consolidation scope and then rework it.

9. XML-XBRL

The choice of IT application for implementing the framework will be a matter of national discretion. However, CEBS considers XML and/or XBRL to be an appropriate tool for implementing a European standardised reporting system, and recommends its use.

XBRL is a language for the electronic communication of business and financial data. It is an open standard, free of license fees, that was developed by a non-profit international consortium.

The IASC Foundation has developed a draft XBRL-taxonomy for IAS/IFRS for general purposes and for financial institutions in particular. The draft taxonomy has been published for comments and is available at http://xbrl.iasb.org/int/fr/ifrs/gp/2005-01-15/.

10. LIAISON WITH WORK ON COMMON REPORTING (COREP)

To address the concerns raised by the industry with regard to co-ordination between financial reporting and prudential reporting on capital requirements, CEBS has begun work in the following areas.

1. The terms and definitions used in the two reporting frameworks;
2. The capital items and prudential filters as presented in the frameworks;
3. Additional financial reporting information needed for capital purposes[5];
4. The scope of consolidation of both frameworks;
5. Pillar III in the two frameworks.

Under terms and definitions, two points were noted for which financial reporting and prudential reporting on capital requirements already coincide. These were identified as 'quick fixes' and adopted in this consultation package. They relate to:

- the inclusion of an additional table – off-balance-sheet commitments other than derivatives;

- the use of the same counterparty breakdown in this framework as in the common reporting framework for the solvency ratio, with an additional split of the category 'institutions' into credit institutions and non-credit institutions.

Other issues relating to the above-mentioned five areas, or to other topics, will be considered during the consultation period. This may result in limited modifications or additions to the tables.

11. Invitation to comment

CEBS welcomes comments on the enclosed financial reporting framework and explanatory guidance. Respondents are requested to **refer in their**

[5] For example, financial information regarding financial undertakings and related subordinated claims that have to be deducted from regulatory capital, financial information regarding transactions with SMEs, and financial information needed for the application of the prudential filters.

comments to the relevant tables and/or paragraphs in the consultation documents. Responses should include the **reasons for the comments and specific suggestions** for any proposed changes in structure or wording.

CEBS invites comment on all matters addressed in the consultation documents. CEBS is particularly interested in comments on the balance sheet and income statements, given their particular importance for supervisors; and on the specific questions presented in the paragraphs below.

Comments should be made in English and should be submitted by 8 July 2005 to CP06@c-ebs.org. Unless respondents request otherwise, comments received will be published on the CEBS website.

<u>Consistency with IAS/IFRS</u>

In developing the proposed framework and application guidance, CEBS sought to be consistent with international accounting standards without being exhaustive (see footnote 1). Each data element in the reporting framework is referenced to the relevant IAS/IFRS or to Common Practice (CP). Recourse to Common Practice was necessary in order to address supervisory needs, given that international accounting standards are not industry-specific.

1. Do respondents agree that the reporting framework is IAS/IFRS consistent? Please indicate where you believe this is not the case.

2. Do respondents believe that the use of Common Practice (CP) is appropriate? Please indicate where you believe this is not the case.

<u>Availability of data</u>

3. Do respondents believe that the data contained in the reporting framework are available within the reporting entity? Please indicate for which data you believe this is not the case.

<u>Degree of detail</u>

4. What additional steps do respondents think CEBS should take to promote further convergence towards a system of regular supervisory reporting that strikes a proper balance on the degree of detail of the information requested.

<u>Explanatory guidance</u>

5. **Do respondents believe that the guidance provided in Annex 2 is appropriate in all respects? We particularly welcome comments on the first chapter of the explanatory guidance.**