7 April 2005

CONSULTATION PAPER ON FINANCIAL REPORTING

ANNEX 2

EXPLANATORY GUIDANCE

CHAPTER I : GENERAL GUIDANCE

This guidance should not be seen as an interpretation of other than presentational issues of the international accounting standards. It is the responsibility of credit institutions and their external auditors to correctly apply the international accounting standards.

1. Application of accounting and measurement rules governing the preparation of consolidated financial reporting package of credit institutions

The consolidated financial reporting package refers to the IAS/IFRS as published by the International Accounting Standards Board (IASB) in the 2004 edition of the *International Financial Reporting Standards, including International Accounting Standards and Interpretations as at 31 March 2004*. These standards have been endorsed by the European Commission with the exception of the two carve-outs (see European Commission Communication of 19 November 2004 and the EC Regulation). Given its importance for the banking sector, the consolidated financial reporting package also takes into account the draft revised IAS 30, known as ED 7 *Financial Instruments: Disclosures.*

The tables refer to the IAS/IFRS. These references concern those provisions of the standards which are relevant for the data requested. Where no reference is available in the IAS/IFRS, references are to Common Practice as used in present practice of supervisors and banks.

2. Choices made

Except where otherwise provided, the amounts to be reported in the tables are as recorded in the balance sheet or income statement (i.e. the carrying amounts).

Tables provide the details for almost every caption of the balance sheet and income statement. The total amount as shown in the table should equal the total amount as indicated in the corresponding caption of the balance sheet or income statement.

The income statement shows gains and losses by nature, including breakdowns in the same order as in the balance sheet, i.e. per portfolio and liquidity. The same approach is used for liabilities.

International accounting standards offer presentational choices. The package recommends:

a. *Product approach vs portfolio approach.*

A choice had to be made between the product approach and the portfolio approach for the presentation of the balance sheet. The portfolio approach was chosen. This choice is vindicated by the draft revised IAS 30 (also known as ED 7).

b. *Trade date vs settlement date (IAS 39.38).*

The international standards give the possibility to account for transactions either on the date the contract was signed or on the date it was executed. This choice may differ according to the class of financial instrument concerned. According to whether banks choose to account for financial instruments on the trade date (date on which the contract was concluded) or on the settlement date (date of availability), there may result a temporary impact on the income statement and balance sheet. However, such impact will very probably be minimal, as a difference in the income statement will only occur where the financial instrument involved is available for sale or held to maturity. The impact on the balance sheet (and on the own funds) is also non-significant.

Given the limited impact of this option provided in the international standards, it has been decided to leave this choice to credit institutions. If however practice shows that this choice may have significant consequences, each supervisory authority might reconsider the issue.

c. *Accrued interest and interest margin*

The IAS/IFRS do not give a clear-cut answer as to whether unpaid accrued interest should be accounted for in a separate caption of the

balance sheet or be included in the portfolio caption to which they relate. It was decided to include in a separate caption of the balance sheet any unpaid accrued interest relating to any portfolio recognized by international standards. In doing so, all financial instruments will have to be accounted for at the clean price (i.e. excluding accrued interest).

The calculation of the interest rate margin may vary from one bank to another as the international standards do not provide guidance in this respect. Supervisors may want to standardise this calculation.

3. Allocations.

Allocation according to the economic sectors

Counterparties composing the allocation concerned are as follows:

- Central governments;
- Credit institutions;
- Non credit institutions;
- Corporate;
- Retail.

The choice is based on the Proposal for European Directive amending the existing Capital Adequacy Directives. The total of "credit institutions" and "non credit institutions" corresponds to the total "institutions" in the COREP reporting.

Past-due

Certain tables require a breakdown of past-due contracts. These tables show the amounts of contracts for which payment is contractually due but has not been received. Amounts of such contracts should be indicated and broken down according to the number of past due days. Impairment amounts should not be included in this allocation.

4. Other general guidance

Repos and reverse repos

In tables relating to repo and reverse repo (tables 43), repos and reverse repos are to be classified by portfolios and in the captions that correspond to the nature of the instrument that is the subject of the repo or reverse repo transaction.

Although this type of information may not readily be available in the bank's accounting system but rather in the front-office database, financial instruments used as collateral in a repo should be accounted for separately from other financial instruments (IAS 39.37a).

Definitions of terms

The terms used originate either from the IAS/IFRS where existent, otherwise from the European Directives or common practice (CP).

CHAPTER II : DETAILED GUIDANCE

1. Derivatives

For each type (nature) of derivative, both the gross notional amount and the carrying amount are mentioned.

When a derivative may be classified in one category or another, e.g. an equity swap, it should be classified in the heading corresponding to the part of the derivative considered by the bank to be the most risk sensitive.

Finally, when the value of the derivative corresponds to a creditor amount, the derivative is recognised at the liabilities side of the balance sheet.

2. Impairment on Available-for-sale financial assets

Concerning the fair value measurement of AFS, it is useful as a first step to let the movements go into equity and as a second step to move the recognized impairment from equity to profit and loss. The amount shown in equity is useful information for supervisors.

Impaired AFS financial assets (according to IAS 39:67-68)

Acquisition cost	100	cumulative loss 30
Fair Value	95	
Impaired Value	70	

(1) Initial measurement of AFS
(2) Fair value adjustment before impairment (loss)
(3) Change in fair value due to impairment (through equity)
(4) Impairment loss through income statement

AFS			
(1)	100		
		5	(2)
		25	(3)

Equity			
(2)	5	5	(4)
(3)	25	25	(4)

P/L			
(4)	25		
(4)	5		

Cash			
		100	(1)

Impaired AFS financial assets (according to IAS 39:67-68)

Acquisition cost	100	cumulative loss 30
Fair Value	105	
Impaired Value	70	

(1) Initial measurement of AFS
(2) Fair value adjustment before impairment (gain)

(3) Change in fair value due to impairment (through equity)
(4) Impairment loss through income statement

AFS				Equity				P/L				Cash			
(1)	100			(3)	35	5	(2)	(4)	30					100	(1)
(2)	5					30	(4)								
		35	(3)												

3. Impairment on loans and receivables and held-to-maturity investments

According to the standards, collective evaluation of impairment can be applied to financial assets that are not individually significant and also to financial assets for which there is no objective evidence of individual impairment. This approach does not preclude an entity to individually evaluate for impairment of insignificant loans.

		Significant loans (e.g. 100 loans)	Insignificant loans
Impaired	**1**	**Individual basis for impairment → 7 impaired loans**	**Collective basis for impairment** **a) choose a factor** **b) choose specific portfolios**
Unimpaired on individual basis	**2**	**Collective assessment for 93 loans**	

In the reporting package, there is a combination of collective evaluation of impairment under step 1 with collective assessment under step 2.

4. Tax assets and liabilities and defined benefit plans

The tables on tax assets and liabilities and on defined benefit plans were developed by the European Committee Central Balance Sheet Office (working group III).

5. Realised gains and losses on financial assets and liabilities other than measured at fair value through profit or loss

This breakdown shows all gains and losses on financial assets not measured at fair value through the income statement that arise at derecognition.

6. Repurchase agreements, reverse repurchase agreements and related agreements

This table shows repos, reverse repos and related agreements in each balance-sheet portfolio. It can include both collaterals transferred that must be identified by the transferor and cash received or loaned out. Tables on repurchase agreements then make it possible to distinguish between these various possibilities.

Table A

This table shows financial assets that have been transferred to a third party within a repurchase agreement and are still recognized in the credit institution's balance sheet. It breaks them down according to their nature and the portfolio in which they are recognized. The balance sheet amounts are not identified separately.

Table B

This table details liabilities recorded by the credit institution in the balance sheet upon receiving financing within a repurchase agreement. Such liabilities should be broken down according to the counterparty.

Table C

This table shows financial liabilities that are to be recognized by the credit institution in its balance sheet upon selling the collateral obtained within a reverse repurchase agreement. These liabilities are to be broken down according to their nature and the portfolio in which they are recorded. The balance sheet amounts are not identified separately.

Table D

Finally, this table presents the breakdown, per counterparty, of the financing obtained within a reverse repurchase agreement.

Example:

Let credit institution B (*transferee*) advance a certain amount to credit institution A (*transferor*), and receive collateral as guarantee.

Transferor (A)	**Transferee (B)**
If the transferee has no right on the collateral (i.e. all risks and rewards stay with the transferor):	
Debit: AFS 100 Credit: Liab/B 100 → **Table B**	Debit: Receiv/A 100, Cash <100> → **Table D**
If the transferee has the right to resell the collateral: (39.37a)	
Debit: ~~AFS 100~~ Loaned Asset 100 → **Table A** Credit: Liab/B 100 → **Table B**	Debit: Receiv/A 100, Cash <100> → **Table D**
If the transferee sells the collateral: (39.37b)	
Debit: Loaned Asset 100 → **Table A** Credit: Liab/B 100 → **Table B**	Debit: Receiv/A 100 → **Table D**, Cash ~~<100>~~ ~~+110~~ 10 Credit: Debt/A 110 → **Table C**