

December 2005

**COVER NOTE
TO THE
FRAMEWORK FOR CONSOLIDATED FINANCIAL REPORTING**

1. Introduction and background

1. The introduction in the EU of international accounting standards (IAS/IFRS)¹ changes the way that credit institutions using these standards prepare their published financial statements. These changes can lead European supervisory authorities to modify their prudential financial reporting requirements, since these reporting requirements are based to a large extent on accounting data. These circumstances have created a unique opportunity to converge and ultimately harmonise prudential financial reporting in Europe, using IAS/IFRS as the basis for a common prudential reporting framework.

2. Accordingly, the Committee of European Banking Supervisors (CEBS) has developed guidelines establishing a standardised consolidated financial reporting framework (FINREP). CEBS published the guidelines for public consultation earlier this year, and approved the final guidelines in December 2005. This cover note provides general background and explanatory information on the guidelines.

3. This initiative was motivated by the fact that IAS/IFRS, unlike Directive 86/635/EEC, do not impose a standardised reporting format. It also responds to calls from the European Commission and the European Council as well as from the industry to reduce reporting burden on EU companies. CEBS believes that a common financial reporting framework for prudential purposes will reduce the reporting burden for credit institutions that operate cross-border, and lower barriers to an efficient internal market in financial services.

4. While convergence in supervisory practices is one of CEBS' declared objectives, CEBS cannot be expected to achieve full harmonisation of prudential financial reporting requirements overnight. The information needs of national supervisors vary from country to country, depending on their approach to prudential supervision. Some supervisors rely primarily on publicly available information, while others resort more to information collected by means of periodic prudential reports. Supervisors also place varying emphasis on on-site versus off-site supervision. Where the focus lies more on off-site supervision, supervisors generally place more importance on periodic prudential reports.

5. These differences explain why the needs of national supervisory authorities for prudential reporting diverge, and why greater convergence in reporting requirements cannot be achieved until supervisory practices have moved closer together. In the meantime, the development of a standardised consolidated financial reporting framework represents an important step towards harmonisation and convergence.

¹ 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, as of 1 January 2005, to use IAS/IFRS for their consolidated financial statements. Member states may also extend the application of IAS/IFRS to the consolidated (and statutory) financial statements of unlisted credit institutions. An overview of EU member states' intentions regarding the 'Planned Implementation of the IAS Regulation (1606/2002) in the EU and EEA (Published for information purposes only)' is available at the website of the European Commission: http://europa.eu.int/comm/internal_market/index_en.htm

2. Objectives and benefits of FINREP

6. FINREP is designed for credit institutions that use IAS/IFRS for their published financial statements and that have to provide similar information in the periodic prudential reports they are required to submit to their supervisory authorities.

7. It establishes a standardised consolidated financial reporting framework that is consistent with IAS/IFRS. This framework provides harmonised reporting formats and a standardised set of information items based on a common accounting framework. CEBS believes that FINREP increases the comparability of financial information reported to different supervisors within the EU and reduces the reporting burden for credit institutions operating cross-border.

8. FINREP represents an important step in streamlining prudential reporting requirements. It is expected to contribute to improving the cost-effectiveness of supervision across the EU and remove a potential obstacle to financial market integration.

3. Structure of FINREP

9. FINREP has been developed on the basis of IAS/IFRS as published by the International Accounting Standards Board (IASB) in the 2005 edition of the *International Financial Reporting Standards, including International Accounting Standards and Interpretations as at 1 January 2005*, and as endorsed by the European Commission. In addition, the framework covers certain elements of *IFRS 7 Financial Instruments: Disclosures*. It is not intended to cover all aspects of IAS/IFRS; rather it focuses on information that is important or relevant for prudential purposes.

10. CEBS has taken care to ensure that FINREP is consistent with IAS/IFRS. There is, however, one instance where a presentational choice available under the accounting framework has been restricted. While IAS/IFRS allow financial instruments to be presented either by product (product approach) or by category (portfolio approach), CEBS decided for the sake of greater standardisation and comparability to adopt a portfolio approach in FINREP. Furthermore, the framework does not allow the possibility of providing certain information in notes, as this would reduce standardisation and the comparability of the required information.

11. CEBS acknowledges that the framework contains a number of requirements that exceed IAS/IFRS disclosure requirements.² These requirements are justified by the relevance of the information for prudential purposes or by its value in establishing a link with COREP. All information items that are not essential for prudential purposes have been excluded.

12. In order to ensure a minimum level of harmonisation and convergence while accommodating the varying needs of different supervisory authorities, CEBS chose to distinguish between 'core' and 'non-core' information. This approach represents a compromise between the need for flexibility to accommodate for the different supervisory needs and the desire for greater convergence and harmonisation. 'Core information' designates the minimum information required by a supervisory authority that chooses to apply the financial reporting framework to credit institutions which use IAS/IFRS as the basis for their prudential reporting on a consolidated basis. CEBS has decided that core information comprises the consolidated balance sheet and the consolidated income statement.

13. The rest of the data elements in the framework are designated as 'non-core information'. These elements provide common data definitions and contribute to greater commonality of reporting requirements among EU supervisors.

² The feedback document explains why information whose relevance was questioned by respondents during the consultation period is relevant to supervisors and therefore continues to be included in the framework.

4. Application of FINREP

14. FINREP is intended for use by supervisory authorities that require supervised credit institutions to submit prudential reports on consolidated financial information based on IAS/IFRS.³ It is not CEBS' intention to introduce a further layer of reporting. Rather, the framework should replace existing consolidated financial reporting frameworks when supervisory authorities choose to change the accounting basis for prudential reporting from national GAAP to IAS/IFRS.

15. The use of the framework is not mandatory. Each national supervisor remains free to decide whether to apply the framework to supervised credit institutions within its jurisdiction. Some supervisors do not collect financial information by means of periodic prudential reports and do not plan to apply the framework to supervised credit institutions. However, once an authority decides to apply the framework it should, at a minimum, require the core information, i.e. the consolidated balance sheet and the consolidated income statement.

16. The extent to which supervisory authorities will have recourse to non-core information will vary from country to country, depending on the degree to which they rely on periodic prudential reports for the purposes of prudential supervision. CEBS believes that the degree of flexibility provided by the framework is necessary in order to accommodate the current differences in supervisory practices.

17. The framework does not prohibit supervisors from requiring additional information not covered by the framework in order to address specific issues at national level. However, they should refrain from asking credit institutions to provide information that is covered by FINREP in a different form, as this would impede CEBS' efforts to achieve harmonisation and convergence. This means that supervisory authorities that apply FINREP should request information covered by the framework in the form that the framework specifies.

5. Cross-border aspects

18. In contrast with the current situation, the framework will enable credit institutions to use the same standardised data formats and data definitions in all countries where FINREP will be applied. This should significantly reduce the burden for credit institutions that operate cross-border.

19. Further reduction in reporting burden can be achieved through future alignment of supervisory practices and, consequently, in the degree to which supervisors rely on periodic prudential returns for gathering data that is necessary for carrying out their prudential responsibilities.

6. Implementation, scope, and reporting frequency

20. The implementation of the framework remains a matter of national discretion. Supervisors will decide when and to which credit institutions the framework will apply. At the discretion of the national supervisory authority, the framework may also be applied - and to the extent necessary, adapted - for sub-consolidated or solo reporting.

21. The consolidation scope of the framework may be defined with reference to either IAS/IFRS or the Capital Requirements Directive, as the national supervisory authority considers appropriate.

22. The reporting frequency of the framework is also a matter of national discretion. Since supervisory needs for financial information differ for different types of information,

³ The framework is not intended for use in a national accounting standards environment, unless national supervisors so choose.

supervisors can be expected to apply different reporting frequencies to and within different parts of the framework.

7. Relation with the common reporting framework for the solvency ratio (COREP)

23. CEBS has taken care to ensure that the framework for financial reporting is aligned as closely as possible with the common framework for reporting of the solvency ratio (COREP) under the Capital Requirements Directive (CRD) which is currently being finalised. CEBS focussed on the links between accounting equity and the calculation of regulatory own funds, as well as on the compatibility of definitions and references.

24. In order to enable credit institutions to use the same systems for both frameworks, FINREP includes an approach that can be used to relate the exposure classes used under the different credit risk methodologies in the CRD to the counterparties used in the Financial Reporting Framework.

8. XBRL

25. National supervisory authorities are free to decide on the technical aspects involved in implementing the framework. CEBS considers, however, that XBRL⁴ can be a helpful tool in constructing a standardised European reporting system. CEBS will develop an XBRL taxonomy, which will be made available without cost to national authorities and supervised credit institutions.

9. Follow-up

26. It is important to stress that CEBS will continue to strive for further convergence in the field of prudential financial reporting and aim to achieve in the medium to long term a fully harmonised prudential reporting environment. FINREP should thus be considered as a first but important step in this direction.

27. In addition CEBS will monitor the implementation of the framework adapt it, where necessary, to address issues that arise from the practical implementation as well as new developments in the area of IAS/IFRS or of prudential supervision.

⁴ 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 taxonomy will allow banks to overcome the presentational limitation referred to in paragraph 10.