Comments to “Consultation Paper on Financial Reporting” (CP06)

published in April 2005

Standpoint of the Czech Banking Association and the Czech National Bank

Introduction

The Czech Banking Association and the Czech National Bank welcome the opportunity to take part in the formal consultation of „**Consultation Paper on Financial Reporting” (CP06),** that was published in April 2005. We appreciate the efforts of CEBS towards a standardised reporting framework for credit institutions.

The Czech Banking Association invited all its member banks to actively participate in the consultation. The summary of comments presented below is a result of discussion with experts from banks and the Czech National Bank.

The Banking Regulation and Supervision Department of the Czech National Bank discussed CP06 with experts from Financial Stability Unit and Monetary and Statistic Department.

Organisation of the Comments

An effort has been made to organise the comments in such a way that they would follow the arrangement of topics and issues in the Consultation Paper. The comments are divided into two categories - general and specific.

Many standpoints of the Czech National Bank and the Czech Banking Association are equal. However, there are issues where the opinion of the banking community and the Czech National Bank is expressed separately.

General comments

A) Joint general comments of the Czech Banking Association and the Czech National Bank

1. From our point of view the proposal of financial reporting needs the additional work to exclude information which is doubled. For instance, the level of detail in balance sheet and in P&L is in many cases the same as in separate tables, e.g. the lines in table 3, 5, 6, 7 and 8 are almost the same as the lines in table 1.1. In the balance sheet and Income Statement should be only the highest level aggregated lines and details should be included in the separate tables.

2. Regarding „common practice", the proposal reduces some options allowed by IFRS, e. g. IFRS does not require reporting of interest income from financial assets held for trading. In other cases applying "common practice" is not meaningful, e.g. differentiating between gains and losses from FX operations or substantial detail in the additional tables concerning Income Statements.

3. We do not support the special items for "accrued interest". In our opinion this "common practice" is inconsistent with IFRS. Our point of view ED 7.10 gives a clear answer concerning "accrued interest". According ED 7.10 an entity shall disclose "carrying amounts" of each of the portfolios, i.e.:
   - fair value,
   - cost (equity instrument that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments),
   - amortised cost (according to 39.3 it is the amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction for impairment or uncollectibility.

   "Accrued interest" (calculating by effective interest method) is not possible to disclose on balance sheet separately since it is a part of "carrying amount". See also related special comments.

B) Separate general comments of the Czech Banking Association

4. The Czech Banking Association expressed the view, that the projected financial framework is too extensive and it requires such a level of detail that may not be necessary. Full set of tables should substitute annual financial statements (excl. a summary of significant accounting policies), therefore different reporting frequency of full set than annually seems unfeasible.

5. The Czech Banking Association expressed the view that the implementation of the full set of tables in the routine operation could mean the considerable burden – not only for reporting and IT departments, but practically for everyone (a significant portion of data is not available within the IT systems of banks for routine reporting).

6. The Czech Banking Association expressed the view that the requirements on the extensive detail concerning fair value in the relation to sectors can be termed problematic. IFRS do not require disclosure of fair value by sectors, but by categories of financial assets and liabilities. Tables 7 and 8, 39 B and C require disclosure of fair value by sectors, tables 19, 20 and 21 by types of deposits. The collection of these data, especially for table 39 C, could be questionable.

7. The Czech Banking Association does not support the division of assets, liabilities, income and expenses according to counterparty sectors.

C) Separate general comments of the Czech National Bank

8. The Czech National Bank would like to mention that the division of assets and liabilities according to counterparty sectors does not correspond with the sector classification according to ESA 95 which is required within the framework of monetary and financial statistics and the European system of accounts. This misalignment can lead to higher reporting burden of banks. The Czech National Bank would like to fill in, that from analytical point of view it is necessary to pick up the assets and liabilities related to the central banks.

9. The Czech National Bank would like to notify, that the project Coordinated Compilation Exercise (CCE) for Financial Soundness Indicators (FSIs) of IMF concerning regulatory reporting of basic parameters of financial stability requires data about residents and non-residents. Let’s mention parameter I5 Sectorial distribution of loans to total banks as an example of obligatory parameters (Core Set). IMF requires Sectorial distribution of loans to be detailed as:
   - loans to residents:
     - deposit-takers
     - central bank
     - OFCs
     - general government
     - NFCs
     - other domestic sectors
   - loans to non-residents

   IMF requires in the Encouraged Set I23 Foreign-currency-denominated loans to total loans.

Special comments

Table 1.1 Consolidated Balance Sheet Statement - Assets

Category "Financial assets held for trading"

10. The line "Debt instruments issued by" should be changed into the line "Debt securities issued by". Debt instruments include reverse repos, loans and securities.

Category "Financial assets designated at fair value through profit and loss"

11. The line "Debt instruments issued by" should be changed into the line "Debt securities issued by". Debt instruments include reverse repos, loans and securities.

Category "Available-for-sale financial assets"

12. The line "Debt instruments issued by" should be changed into the line "Debt securities issued by". Debt instruments include reverse repos, loans and securities.

13. The new line called "Investments in subsidiaries, associates and joint ventures measured at fair value" should be inserted - 39.2(a). These investments in subsidiaries, associates and joint ventures are not included in the balance sheet.

Category "Loans and receivables (including finance leases)"

14. The line "Unquoted loans and advances" should be changed into the line "Loans and advances". According to IAS 39.9 the whole category "Loans and receivables" refers to unquoted instruments.

Category "Held-to-maturity investments"

15. The line "Quoted debt instruments issued by" should be changed into the line "Debt securities issued by". Debt instruments include reverse repos, loans and securities.

Category "Accrued interest income on financial assets"

16. The whole category "Accrued interest income on financial assets" should be deleted. This approach is not broadly acceptable "common practice" and as well IAS 39 does not distinguish between principal and accrued interest. Accrued interest is part of carrying amount of any debt instrument. If there is a need for analytical purpose to have information about accrued interest income, it is necessary to draw such information outside financial statements.

Table 1.2 Consolidated Balance Sheet Statement - Liabilities

Category "Financial liabilities held for trading"

17. The structure of "*Financial liabilities held for trading*" and *"Financial liabilities designated at fair value through profit and loss"* is inconsistent with table 18.

18. The line "Subordinated liabilities" should be deleted and all subordinated liabilities should be disclosed together (new line "Subordinated liabilities" should be included before the line "Provisions").

Category "Financial liabilities designated at fair value through profit and loss"

19. The lines "Deposits from ..." should be renamed into "Liabilities to ...". Liabilities are broader than deposits.

20. The line "Subordinated liabilities" should be deleted and all subordinated liabilities should be disclosed together (new line "Subordinated liabilities" should be included before the line "Provisions").

Category "Financial liabilities measured at amortised cost"

21. The line "Subordinated liabilities" should be deleted and all subordinated liabilities should be disclosed together (new line "Subordinated liabilities" should be included before the line "Provisions").

Category "Accrued interest expenses on financial assets"

22. The whole category "Accrued interest expenses on financial assets" should be deleted. IAS 39 does not distinguish between principal and accrued interest. Accrued interest is part of carrying amount of any debt instrument. If there is a need for analytical purpose to have information about accrued interest expense, it is necessary to draw such information outside financial statements.

New category "Subordinated liabilities"

23. The new line should be included before the line "Provisions" for all subordinated liabilities.

Table 1.3 Consolidated Balance Sheet Statement – Equity and Minority Interest

24. We recommend joining table 1.2 and table 1.3 for operational reasons.

Table 2 Consolidated profit and loss

All categories

25. The text "(only interest flows)" and "(excluding interest flows)" should be deleted in all cases. There is no requirement in IFRS, e.g. ED 7.21(b). In the case of derivatives, accrued interest on underlying asset equals to accrued interest on underlying liabilities. So net accrued amount is zero. According to ED 7.21(c) an entity shall disclose total interest income and total interest expense (calculated using the effective interest method) for financial assets and financial liabilities that are not at fair value through profit or loss.

Category "Interest net income"

26. The title of this category should be renamed into "Net Interest income".

27. The line "Financial assets held for trading" should be changed into "Financial assets held for trading (if shown separately)". There is no requirement to separate an interest component. According to IAS 32.94 and 39.55 it is allowed to disclose interest income as a part of gains/losses from fair value revaluation. CEBS should not reduce this option allowed by IFRS.

28. The line "Financial assets designated at fair value through profit of loss" should be changed into "Financial assets designated at fair value through profit of loss (if shown separately)". There is no requirement to separate interest component. According to IAS 32.94 and 39.55 is allowed to disclose interest income as a part of gains/losses from fair value revaluation. CEBS should not reduce this option according to IFRS.

29. The lines "Derivatives used for hedging" within interest income and "Derivatives used for hedging" within interest expense should be deleted. Accrued interest on underlying asset equals to accrued interest on underlying liabilities. So net accrued amount is zero.

Category "Fee and Commission net income"

30. The title of this category should be renamed into *"Net Fee and Commission income "*.

Category "Gains and losses on financial assets and liabilities"

31. The Czech National Bank expressed the view, that gains and losses from derivatives should be separated from gains and losses from other instruments.

Table 7, 8, 19, 20, 21 and 22

32. The Czech Banking Association expressed the view, that the detail in this table exceeds the requirements according to ED 7.26.

Table 9

33. We support a similar structure of table 9 as within table 4, i.e. put together assets and liabilities parts and split columns (carrying amount – assets, liabilities, notional amount – assets, liabilities).

Table 10

34. The whole table should be deleted.

Table 12.B

35. The column „Fair value“ is not relevant for all lines, as well according to IAS 40.79(e) the detail is not required.

Table 17

36. The Czech Banking Association expressed the view, that table 17 should be deleted.

Table 18

37. The parts A and B of the table 18 should be numbered separately as table 18 and table 19 in order to keep consistency with the principle used in tables 3, 4 and 5 which represent assets in fair value through profit or loss.

Table 19, 20, 21 and 22

38. The heading of the tables should include " … measured at amortised cost".

Table 19 a 20

39. Both tables should merge and it is advisable to use the same structure, e.g. sectors in table 20 should be in lines.

Table 22

40. The whole table should be deleted.

Table 26

41. The Czech National Bank expressed the view, that the portfolio principle is already used in Income Statements and in table 26 it is advisable to replace it by sector principle. The Czech Banking Association does not support this view.

Table 28

42. The Czech National Bank would like to recommend including line for fees from FX activities, as such fees can be material in non-Euro countries. The Czech Banking Association does not support this recommendation.

43. The Czech Banking Association expressed the view, that the detail in this table exceeds the requirements according to IFRS and the detail of securities should be deleted.

Table 30

44. Table A in table 30 only repeats lines from Income Statements and thus it is advisable to delete them.

Table 32

45. IFRS do not require dividing gains and losses in hedge accounting.

Table 36

46. The Czech National Bank expressed the view, that the new lines "Audit fees", "Tax advisory fees" and "Legal and other professional fees" instead of "Professional fees" should be inserted. The Czech Banking Association does not support this view.

Table 39

47. The content of columns (specially “Maximum credit exposure”) is not specified. As well the purpose of the footnote 1) is unclear.

48. In the Czech National Bank’s opinion table 39 should not be restricted only on portfolios “not measured at fair value through profit or loss” as Table D should contain all credit exposures. From analytical point of view it is necessary in Table D to have credit exposures in the same value – gross carrying amount (without allowances or loss impairment recognised directly). The correction of table D is easier than inclusion of additional information about gross carrying amount in Table 3 a 5. The data about total credit exposures for different classes (not for different portfolios) in gross carrying amount in Table D will be important source of data not only for analyses but also for Financial Soundness Indicators.

Table 40 and 41

49. The columns should have similar structure of maturities (repricing dates). The columns of higher maturities should be included in table 40, e.g. 1 M or less, 1M – 3 M, 3M – 1 Y, 1 Y – 5 Y, 5 Y – 10 Y (this column should be included in the Czech National Bank opinion), more than 10 Y, Undetermined, Total.

50. The 3 lines should be included: for total assets, total liabilities and total interest sensitivity gap (i. e. the difference between total assets and total liabilities).

51. In the Czech National Bank’s opinion the division of assets should contain not only portfolio view but also sectors view (liabilities side is divided into portfolios and sectors). The Czech Banking Association does not support this view.

Table 41

52. There should be two main groups of lines: one for banking book and the other for trading book. Each of the group should have the final line: “Banking book” and “Trading book”.

Table 44A

53. Is unclear whether the definition of key management according IAS 24 should by use or it will be more specific.

Table 44.B

54. The Czech Banking Association expressed the view, that the detail of expenses and income from related party transaction exceed the IFRS requirements. The Czech Banking Association considered that collecting this information might not be in some cases adequate. For example, if banks issue publicly traded bonds and related party will buy part

of the issue, banks are unable to follow what interest income they earned (i.e. what is interest expense of banks) unless these bonds are bought when issued and held to maturity.

Table 47

55. Due to no added value of cash flow statement in the banking industry the detail of this table is not adequate.

Table 48 - columns

56. The structure of the table 48 should be harmonised with the table 1.3 Equity and minority interests.

Table 48 - rows (Source of equity changes)

57. We recommend replacing this table by standardised statement of changes in equity according IAS 1 – a column format that reconciles the opening and closing balances of each equity components (columns = equity components, lines = sources of equity changes).