



BASEL COMMITTEE ON BANKING SUPERVISION

BANK FOR INTERNATIONAL SETTLEMENTS



LETTER OF COMMENT NO. 173

Chairman

VIA EMAIL: commentletters@iasb.org

Sir David Tweedie
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

14 April 2009

Discussion paper – Preliminary Views on Financial Statement Presentation

Dear Sir David

The Basel Committee on Banking Supervision (the Committee) welcomes the opportunity to comment on the International Accounting Standards Board's (IASB) Discussion Paper *Preliminary Views on Financial Statement Presentation*. The Committee has a strong interest in high quality financial reporting by banks and has carefully analysed the discussion paper (DP).

The Committee welcomes the IASB's continued efforts to improve financial reporting and disclosure in a harmonised manner with the Financial Accounting Standards Board. We find value in the broad objectives of cohesiveness and disaggregation as they generally increase transparency. The Committee is not, however, fully persuaded that the proposals presented in the DP are appropriate for financial services entities; in particular for banks. Notably, the Committee considers that the proposal for the classification of assets and liabilities is not relevant for financial services entities because, as noted in paragraph 2.78 of the DP, "...the source of profitability for a financial services entity is usually the management of financial assets and financial liabilities". Additionally, the Committee does not think that the benefit of the DP's proposals outweigh the costs of preparing (and auditing) the suggested information for banks. As such, we believe that the proposed financial statement presentation needs further work and the IASB should engage banks in a discussion to arrive at a more useful presentation of banks' financial statements for users than the proposals in the discussion paper.

As major users of banks' financial statements, Committee members have four main concerns with the proposals presented in the DP. The four concerns are outlined in the paragraphs below.

The first concern of the Committee is that a change in the presentation of financial statements for financial services entities should provide significant benefits to the costs required to make the changes. As banking supervisors we find that financial services entities already have comparable and well established financial presentation and robust financial ratios that are used on an international basis for financial statement analysis. While the current stresses in financial markets have required accounting standards setters to re-examine a number of issues, we are

not aware of a call to change the primary financial statements. In fact, bank supervisors and most of the users they have consulted find the current presentation and ratios appropriate for, among other things, predicting future cash flows. In addition, the proposed financial statement presentation would complicate the calculation of key ratios used in the analysis of financial results for financial services entities which could lead to less transparency, comparability and understandability.

Our second concern is that the distinction between the business and financing sections and the categorisation within the business section between operating and investing are not defined meaningfully. Such clarity is needed to result in a consistent application of the management approach for financial services entities, especially banks. Through our analysis of the DP and discussion with banks we found significant confusion as to how to classify the common business functions of banks. The distinction in the DP for classification of banking activities is missing thus making it arbitrary and reducing comparability across banks. We suggest that in the further work to be undertaken, a more meaningful classification is considered for banks. In our view, the classification of cash flow items, statement of financial position items and comprehensive income items into operating, financing, and investing activities will not be decision useful. Requiring banks to make a distinction would reduce comparability of financial information across banks and would likely not meet the IASB's cohesiveness objective.

The third concern deals with the DP's view of the use of a management approach to classify assets and liabilities. In general the Committee acknowledges that using the concept of "through the eyes of management" allows banks to better reflect the management intent in financial reporting. However we find the DP lacks substance that would assist financial services entities in the classification of categories. We believe that use of a management approach as presented in the DP for financial statement presentation may cause current globally consistent presentation to become less comparable. Comparability is important and we note that the Conceptual Framework identifies "comparability" as an enhancing qualitative characteristic of financial statements. Specifically, users must be able to compare the financial statements of different entities in order to evaluate their relative financial position, performance and changes in financial position.

Our fourth concern relates to the need for more transparency in the presentation of realised and unrealised fair value gains and losses in the financial statement presentation of financial services entities and especially the banks we supervise. We note that the DP attempts to enhance the level of transparency through its proposal to present a schedule in the notes to the financial statements. The proposed schedule reconciles cash flows to comprehensive income and disaggregates comprehensive income into four components. In our view, this presentation does not meet the call for a reduction in complexity. The Committee believes that a sufficient level of transparency for realised and unrealised fair value gains and losses can be achieved through specific presentation in the primary financial statements rather than creating a complex schedule for financial services entities. The DP proposal for a reconciliation would not meet the DP's objective of disaggregation.

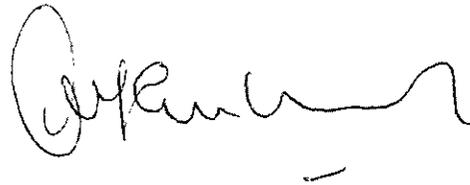
Given these concerns, the Committee recommends that further work be undertaken and in which we would be willing to participate. We suggest that the IASB liaise with financial services entities to ensure that the financial statement

presentation project is meaningful for such entities going forward. Further work should include a more careful consideration of the cost of implementing the new presentation format vis-à-vis its benefits, enhanced comparability across entities and disaggregation of realised and unrealised fair value gains and losses.

These comments, and the additional ones in the attached appendix, have been prepared by the Committee's Accounting Task Force, chaired by Sylvie Mathérat, Director of the Banque de France, and have been approved by the Committee. The Committee trusts that you will find its comments useful and constructive. The team that has analysed the DP will be pleased to meet with the IASB staff to discuss these comments further.

If you have any questions regarding our comments, please feel free to contact Sylvie Mathérat (+33 1 4292 6579), Karen Stothers (Canada's Office of the Superintendent of Financial Institutions), who chairs the Financial Statement Presentation Work Team (++1 416 973 0744), or Xavier-Yves Zanota at the Basel Committee Secretariat (+41 61 280 8613).

Yours sincerely

A handwritten signature in black ink, appearing to read 'Nout Wellink', with a horizontal line underneath.

Nout Wellink



Appendix

In this appendix, the Committee provides additional comments on other selected issues.

Objectives and principles of financial statement presentation

In addition to the concerns raised in our letter, we believe that careful consideration is needed to ensure that too much information does not negatively impact the quality and readability of financial statements and, more specifically, that these objectives are applied in a meaningful manner for financial services entities.

Building on our stated second concern regarding categorisations in our covering letter, we note that paragraph 2.40 of the DP states, "...In the financial services segment, the main operation consists of earning a higher return on financial assets than is paid on financial liabilities and, therefore, the financial instruments are classified in the operating category." We appreciate that the DP noted this distinction and went so far as to include an illustration of the financial statements of a financial services provider (i.e., "Illustration 2: Bank Corp"). In our view, the illustration served to highlight the anticipated difficulty that banks will have in separating financing assets and liabilities categories from the operating and investing categories of the business section. In particular, the categorisation of federal funds purchased and sold as "financing liabilities and assets" was viewed as an operating activity rather than a financing activity by many. We are concerned that the lack of specific guidance will create a lack of comparability and may require users of financial statements to aggregate information in order to make financial statements comparable. As such, the objective of the DP of disaggregating information may not be achieved for financial services entities. We note that paragraph 2.7 of the DP indicates that an entity should, "...disaggregate information in its financial statements in a manner that makes it useful in assessing the amount, timing and uncertainty of its future cash flows" and believe the proposed categorisation is not useful for banks."

Our concerns with regard to the lack of comparability are heightened by the fact that, as recognised in paragraph 2.42 of the DP, an entity's use of an asset or liability might change over time. While we understand from paragraph 2.41 that, as long as there is no change in an entity's policy for classifying its assets and liabilities, a change in how an asset is used would not represent a change in accounting policy (and require retrospective application), it is not clear to us whether the comparability issue will be addressed when the boards discuss whether and how a change in the use of an asset or liability should be presented in the financial statements.¹

¹ Paragraph 2.42 notes that this is yet to be discussed by the boards.

Implications of the objectives and principles for each financial statement

Statement of financial position (Questions 11 to 13):

The Committee believes that the disclosure of information about liquidity is very important for users of financial statements of financial services entities. However, the Committee is of the view that the need for liquidity information is better met with through disclosure rather than financial statement presentation. In fact, the IASB and the industry are working on increased disclosures for liquidity currently and we expect this will cover the needs sufficiently.

The Committee agrees that cash equivalents should be presented and classified in a manner similar to other short-term investments; not as part of cash.

Statement of comprehensive income

We are of the view that the disclosure of "net income" is required in the statement of comprehensive income and caution that the presentation of comprehensive income and its components in one statement may obscure this information. The clear distinction of net income and other comprehensive income components is important. This is due to a fundamental difference in the ability of many components of other comprehensive income to absorb losses and maintain permanency. As such, many components of other comprehensive income are filtered for regulatory capital purposes.

Statement of cash flows

We believe that banks should be permitted the option of using either the direct or indirect method.